TR 93/26 - Income tax: issues relating to the horse industry

Taxation Ruling
Income tax: issues relating to the horse industry

other Rulings on this topic

IT 2289 ; IT 2585; CITCM 761

*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling discusses several issues raised in the taxation of horse breeding, training and racing activities, including :

(a) whether the activity is a hobby or a business to determine whether income from the activity is assessable under subsection 25(1) of the *Income Tax Assessment Act 1936*, and whether expenditure incurred in relation to that activity may be claimed as deductions under subsection 51(1), section 54 and other relevant sections;

(b) whether a racehorse is live stock and accounted for in accordance with Subdivision B of Division 2 of Part III, or whether a racehorse is plant and depreciable under section 54;

(c) the application of the average cost method, the cost method, the special closing value method and the market value method for the purposes of sections 32 and 32A in relation to the valuation of live stock;

(d) the consequences of capital gains and losses (for the purposes of section 160L) on disposal of a horse;

(e) the taxation treatment of stallion syndicates, ie., writing down the value of horses under sections 32 and 32A, whether a partnership exists in terms of Division 5 of Part III, and financial arrangements such as those referred to as 'leases';

(f) clarifying the deductibility of stallion service fees paid in advance as affected by section 82KZM;

(g) assessability of stallion service fee income; and

(h) reminding taxpayers that it is possible to request private rulings to clarify matters.

Ruling

(a) Whether the activities are a hobby or a business

2. The first and most common question raised by taxpayers in relation to horses is whether their activities amount to a business or a hobby. The courts have determined that amounts received in the carrying on of a business (but not a hobby or a pastime) are income. Subsection 25(1) includes gross income as the assessable income of the taxpayer.

3. If the activity is a business, the taxpayer is assessed on receipts from that activity but may claim deductions for non-capital business expenses. If the activity is a hobby, any profits are not assessed and any expenses cannot be claimed as a deduction.

4. In deciding whether a taxpayer is involved in a business or a hobby, each case must be decided on its own facts after examining all the relevant matters. For this purpose, taxpayers engaged in the horse industry fall for consideration into three categories, each of which is discussed separately below.

(i) Racing without associated breeding or training activities of the taxpayer

5. As a general rule the racing of horses is not accepted as a business if it is not associated with breeding or training activities of the taxpayer.

6. To overcome the general rule and demonstrate that the racing of horses is being conducted as a business rather than a hobby, a taxpayer must:

- Demonstrate that he or she is conducting the activity as a business with an intention of making a profit and not primarily for pleasure or because of an interest in the activity,
- Demonstrate that the activities are so considerable, systematic and organised as to exceed the activities of a keen follower of the turf,
- Demonstrate that the activity is being conducted in such a way that it is reasonable to expect that it can become commercially viable, and
- Demonstrate that the activity does not rely primarily on chance as distinct from business acumen.

7. In particular it may be necessary to outline whether, given the number and quality of the horses, it is reasonable to expect that the taxpayer can make a profit if the horses are reasonably successful.

8. In evaluating submissions on this point, it is worth noting that around 80% of foals get to the racetrack, and about half of these will win a race. According to 1989/90 statistics for thoroughbred horses, 37,264 horses competed in 25,214 races, with an average of 6.3 races per horse. The average prize money per race was $7,555 and the average prize money per horse was $5,097. In contrast, the estimated minimum annual cost of maintaining a racehorse was between $15,000 and $24,000 in 1992.

9. It is relevant to look at whether:

- The taxpayer acts on expert advice or has expertise in relation to the training and racing of horses,
- Records are maintained in a business-like manner, and/or
- The activities do not rely primarily on chance to be commercially viable.

(ii) Breeding, whether or not combined with racing

10. To demonstrate that the breeding, or racing and breeding, of horses is being conducted as a business rather than a hobby, a taxpayer must satisfy the tests set out in paragraph 6.

11. Relevant factors would be:

Number, quality and turnover of horses

- The quality and number of horses. As a broad guideline, it is expected that the breeder would have at least six quality or commercial brood mares. Although it is difficult to define what is a quality horse, the quality of the horses will be a relevant factor. If the horses are of excellent quality, special consideration may be given to breeders with fewer than six mares.
- Is the taxpayer regularly selling stock to the general public, for example at yearling sales, to generate a cash flow?
- Are the mares being served regularly?
- Is the taxpayer using its stallion rights?
- Excluding horses which are being raced, does the taxpayer maintain geldings, barren female horses or other horses which are inappropriate for breeding?
- Does the taxpayer sell colts?

In evaluating submissions on this point, it is worth noting that the average price received in major Australian yearling sales in 1990 and 1991 was $17,600 and $12,600 respectively.

Businesslike operation

- Are the activities being conducted in a systematic, planned and business-like manner?
- Does the taxpayer act on expert advice or have expertise in relation to the training, racing or breeding of horses?
- Are the records maintained in a business-like manner?
- The fact that an operation is or is not conducted via a company structure is not decisive.

Other factors

- Is the activity combined with other income-earning activities such as training other people's horses?

Factors which are not so relevant, but which may be addressed are:

- Time put into the operation. This is not decisive. A venture can still be a business even if the taxpayer has another full-time job, or a hobby even if the taxpayer devotes a substantial amount of time to the activity.
- Assets. This is also not decisive. Taxpayers may be considered to have a business even if they do not own property or stables. If they own a stud farm they may still not be engaged in a business.
- Level of success. This, too is only indicative. A successful operation can still be considered to be a hobby rather than a business.

12. The activities of racing and breeding may be considered together, as in *Case Q73* 83 ATC 368; 27 CTBR (NS) *Case 4*. Alternatively, the activities of racing and breeding may be considered separately to decide whether a business of racing and/or a business of breeding is involved, as in *Hawes v. Gardiner* (1957) 37 T.C. 671 and *Case E22* 73 ATC 168; 18 CTBR (NS) *Case 75*. The racing of own-bred horses to prove or add value to them or to related stock may be part of a breeding business (although such horses may not be horse breeding stock for the purposes of section 32A). However, the breeder who maintains a gelding that is not related to his or her racing stock and races it, could not generally claim those racing costs against his or her

breeding income, unless the breeder was involved in a business of racing as well as breeding.

13. If the operation is not considered to be a business in one year, that will not prevent the operation being considered to be a business in later years, as the method of operation, the scale of operations, the quality of the horses used, etc. may improve sufficiently to warrant a different conclusion. It is possible that this change-over point may occur before profits begin to be made.

(iii) Racing and/or breeding associated with training

14. If a taxpayer is in the business of training other people's horses, the fees are assessable income.

15. Whether a horse trainer's own racing and/or breeding activity is part of his or her business turns on the particular circumstances. However, the fact that it is associated with an income-earning training activity is a positive but not determinative factor taken into account in deciding that question.

(b) Live stock or plant?

16. If a taxpayer is carrying on a business, any horses, including racehorses, should be either:

- Depreciated as plant, or
- Included in the live stock accounts.

17. A racehorse should be treated as live stock if the sole or main purpose for maintaining the horse is to sell the horse or its bodily produce including any progeny. Thus, if the racing of a horse is incidental to or tied to the purpose of selling the horse or its progeny, the horse is live stock.

18. Horses that have been bred by the taxpayer and subsequently become geldings may still be treated as live stock, provided the dominant intention is to sell the horse, otherwise they could be regarded as plant.

19. On the other hand, if the primary purpose for maintaining the horse is to race it in order to win prize money, it should be depreciated as plant. Normally, horses owned by bookmakers and horse trainers are maintained for these purposes and would be regarded as plant.

20. Shares in stallion syndicates may be treated as live stock. The purchase of a stallion service right only, is not a purchase of live stock (generally associated with standard bred horses).

21. If the sole or main purpose for maintaining a horse or a share in a horse is to obtain or sell service fees, the horse or share in the horse would not be live stock but plant.

22. The effective life of an item of plant is the period during which the item can be reasonably expected to be used for income producing purposes by any person (section 54A). This period would include any post-racing income producing use of the horse, such as breeding. Thus, if a racehorse was to be raced and then, later on, used for breeding, the effective life of the horse for depreciation purposes would include both the time that the horse was likely to be raced and the time that it was likely to be used for breeding purposes. Alternatively, the taxpayer may adopt the period of 10 years specified in IT 2685.

23. As horses do not race before they turn two, the earliest date available for depreciation is 1 August of the year they turn two. This is the earliest date the 'plant' is installed ready for use for producing assessable income [subsection 54(1)].

(c) Valuation of live stock

24. The difference between the value of live stock and trading stock at the beginning and end of the taxation year is either deductible (if the total value has fallen) or assessable (if the total value has increased).

25. A horse which is live stock may be valued, at the option of the taxpayer, using either:

- The cost price method,
- The market selling method,
- Additional options available under the former section 32 and section 32A (special closing value method), or
- If the Commissioner is satisfied that there are circumstances which justify the adoption by the taxpayer of some other value, the taxpayer may adopt that value. One alternative method is outlined in paragraph 30.

(i) Cost method

26. Horses which can be individually identified cannot be valued in the live stock accounts using the average cost method. This is in

accord with Taxation Ruling IT 2289 and *Rowntree v. F. C. of T.* (1934) 3 ATD 32.

27. Where the taxpayer does not exercise one of the other options available for valuing horse breeding stock, the stock will be taken into account at its cost price (subsections 32(3) and 32A(4).

(ii) Other methods

28. A value other than cost, market selling value, the former section 32 value or the section 32A value may be adopted if the taxpayer satisfies the Commissioner that there are circumstances which justify the adoption of another value (subsections 32(2) and 32A(3)).

29. A taxpayer may value named stud horses at market selling value or under the options available under section 32A or the former section 32, while other stock owned by the taxpayer is valued at cost. On the condition that the practice is restricted to named and identified stud horses where the initial high value of the horses is expected to diminish significantly over a small number of years, the taxpayer does not need to seek the leave of the Commissioner in advance.

30. Canberra Income Tax Circular Memorandum 761 outlined this practice and an administrative practice which allows a different method of valuation, as follows:

> "Leave might be granted in terms of the proviso to section 32 [now subsection 32A(3)] to bring named and identified stallions to account at market selling value even if the balance of the breeder's live stock is valued at cost; and as a general rule, a market selling value estimated by writing 20% off the cost price of a stallion in each successive year of its life would be acceptable.
>
> The estimation of market selling value by means of such annual reductions is to be subject to modification, however, if there is any concrete evidence of a higher market selling value, or if the breeder can substantiate a lower market selling value."

31. This approach has been extended to brood mares. It is open to a taxpayer to establish that the actual diminution in the market selling value during a year of income was greater than 20% of cost. On the other hand, if during a year of income the taxpayer were to receive a firm offer to buy the animal, or obtain a professional valuation, or there was some other evidence that the animal had maintained or increased its value from the previous year, the 20% reduction would not be available.

(iii) Section 32 - Horses acquired after 20 August 1985 and before 19 August 1992

32. The special valuation options in the former section 32 may be used for horses:

- Which are live stock and 3 years old or older,
- Which were acquired under a contract entered into after 20 August 1985 and before 19 August 1992, and
- Which were not, at the time the contract was entered into, a gelding or a spayed female horse.

33. The additional options for writing down the cost of horses which satisfy these requirements are:

- The cost of a stallion may be reduced by 50% per annum on a diminishing value basis,
- The cost of a mare may be reduced by 33 1/3% per annum on a diminishing value basis, or
- The cost of a mare may be reduced by a minimum of 3 annual amounts that will reduce the value of the mare to $1 by the time the horse is aged 12 years or more.

These methods may be used even if the value of the horse remains the same or increases.

(iv) Horses acquired from 19 August 1992

34. The special valuation options in section 32A may be used for horses (defined as "horse breeding stock"):

- Which are live stock and 3 years old or older,
- Which were acquired by the taxpayer under a contract entered into on or after 19 August 1992, and
- Which are held by the taxpayer for breeding purposes.

Contract

35. The horse must have been acquired under a contract and the contract must have been entered into on or after 19 August 1992. The horse need not have been acquired as breeding stock. So horses not acquired under a contract (say, because they are bred by the taxpayer) will not have the option of being valued at the special closing value.

Age of the horse

36. The age of the horse will be relevant in determining whether the horse is three years old and therefore eligible to be valued at the special closing value. It will also be relevant in calculating the special closing value of female breeding stock. The age of a horse will be the number of years after its "birth date" (subsection 32A(10)).

37. The "birth date" (a defined term) depends on whether the horse was foaled before or after 1 August. If the horse was foaled on or after 1 August the birth date is 1 August in that calendar year. If the horse was foaled before 1 August, the birth date will be 1 August in the previous year. For example, a horse foaled on 1 September 1989 will have a birth date of 1 August 1989, and one foaled on 1 July 1989 will have a birth date of 1 August 1988. (subsection 32A(13)).

Held for breeding purposes

38. Horses must be held for breeding purposes to qualify for the special valuation options. The horse must not merely be capable of breeding.

39. This requirement is different from the previous concession which was available as long as the horse was at least three years old, and was not a gelding or a spayed female horse at the time the contract to acquire it was entered into.

Section 32A options

40. The additional options for writing down the cost of horses which satisfy these requirements are:

- Male horse breeding stock may be written down at a maximum rate of 25% on a prime cost basis,
- Female horse breeding stock may be written down on a prime cost basis so that the value is not less than $1 by the end of the year in which the horse is aged 12, with a maximum write-off of 33 1/3% of cost price.

Opening value of stock

41. Where the horse was live stock at the end of the previous year of income and was held for breeding purposes for the whole of the year of income, the opening value will be the value of the horse at the end of the previous year of income (paragraph 32A(7)(a)).

42. If the horse became breeding stock during the year of income, even if it had previously been held as breeding stock, the opening value will be the lesser of:

(a) the original cost of the horse, or

(b) the depreciated value of the horse (section 62) when it became live stock of the taxpayer (paragraph 32A(7)(b)).

Depreciated value of horse

43. The depreciated value of a horse (or any depreciable asset) is its cost less the amount of depreciation allowed as a deduction, or which would have been allowable if the horse (or other asset) had been used wholly for the purposes of producing assessable income.

44. Where a horse that became breeding stock during the year of income was not previously used by the taxpayer for the purpose of producing assessable income, it will have a notional "depreciated value". That is, the depreciated value of the horse will be the difference between its cost and the amount of depreciation that would have been allowable as a deduction if the horse had been wholly used for the purpose of producing assessable income.

45. Where a taxpayer has used a horse for the purpose of producing assessable income, and then uses it for breeding purposes, its "depreciated value" will be its actual depreciated value.

The Special Closing Value and Reduction Amount

- **Special Closing Amount**

46. The special closing value will be the "opening value" less a "reduction amount" or $1 (subsection 32A(6)). The special closing value will be $1 where:

- A female horse is 12 years of age or older (see para. 93: "Age of the horse") [paragraph 32A(6)(a)], or
- A horse (male or female) has been written-down to the point where the "reduction amount" exceeds the "opening value" [paragraph 32A(6)(b)].

- **Reduction amount**

47. The reduction amount is the amount by which horse breeding stock can be written down for the year of income. An amount is deducted from the opening value to arrive at the special closing value of a horse.

48. The maximum amount by which male horse breeding stock can be written-down is 25% of the cost. The reduction amount for male horses is calculated using the formula: [subsection 32A (8)].

$$\text{Base amount} \times \text{Nominated percentage} \times \frac{\text{Holding days in year of income}}{\text{Total days in year of income}}$$

49. Female horse breeding stock can be written down on a prime cost basis so that the value is not less than $1 by the end of the year in which the horse is age 12. The reduction amount for any year, however, cannot be greater than 33 1/3% of the cost of the horse.

50. The reduction amount for female horse breeding stock is calculated using the formula:[subsection 32A(9)].

$$\frac{\text{Base amount}}{\text{Reducing factor}} \times \frac{\text{Holding days in year of income}}{\text{Total days in year of income}}$$

- **Formula items**

51. "Base amount" is the lesser of either the original cost price of the horse, or its depreciated value. (See paragraph 43 on "Depreciated value").

52. "Nominated percentage" (male horses only), is the percentage of the cost of a horse which the taxpayer nominates to write down for a particular year of income. It cannot be greater than 25%. A horse will not have to be written down by the same percentage each year.

53. See example 'D' for an example of a calculation.

(d) Capital gains on disposal of horse

54. If a horse is live stock and hence trading stock, any consideration received on its disposal is included in assessable income by subsection 25(1) or subsection 36(1), and excluded from the capital gains provisions (subsection 160L(3)).

55. If a horse is plant, any capital gain on disposal is still subject to the capital gains provisions. If the horse has been used for the purpose of producing assessable income and depreciated, the difference between the cost of the horse and its written down value is a balancing charge or deduction. This applies to race horses if, as discussed above, there is no intention, or only an incidental intention, to sell the horse or its progeny.

56. As explained in Taxation Ruling IT 2585, if a horse which is not live stock is used or kept primarily for the personal use or enjoyment of the taxpayer, the horse is a personal-use asset in terms of section 160B. Any capital gain will be subject to tax under the special provisions relating to such assets (see section 160ZG). A capital gain

is not deemed to accrue as a result of the disposal of a non-listed personal use asset if the consideration received is less than $5000. Where a capital loss occurs, subsection 160Z(7) excludes the loss from being taken into account for the purposes of Part IIIA, so that a capital profit on one horse may not be offset by a capital loss on other horses.

(e) Stallion syndicates

57. Most stallion syndicate agreements generally specify that a stallion will be syndicated into 40 or more shares, which will be offered for sale to the public. A manager is appointed to look after the stallion on behalf of the buyers. The manager generally incurs all costs of the horse (such as feed, vetting, stabling and advertising, etc.). In return the manager receives "standing rights" (eg. 6 free stallion services rights each year). If excessive vetting and advertising is involved the syndicate members may be liable for the extra expenses as per the syndicate agreement. The members are bound by the syndicate agreement.

58. The stallion manager acts on behalf of the collective syndicate members and attempts to sell stallion services to other horse breeders. This is called income from "overs". As the stallion manager normally bears all costs of the horse, the syndicate should receive the gross profit from the sale of "overs".

59. A share in a stallion normally entitles the owner to have his or her mare served free of charge each year, or the service right might be sold by him or her each year.

60. The treatment of a syndicated horse depends on who owns the horse and whether there is a partnership for taxation purposes. This Ruling does not cover racing syndicates.

(i) Who owns the horse?

61. Stallion syndicate agreements specify who owns the horse. Normally the horse is not owned by the syndicate (partnership), but owned individually by the respective shareholders, who collectively lend their share of the horse to the syndicate in order for it to derive income from "overs".

62. In such a situation, only those members who are carrying on a business of horse breeding are entitled to write off their interests in the horse in their live stock accounts.

(ii) Is there a partnership?

63. If the syndicate is 'an association of persons carrying on business as partners or in receipt of income jointly', it will be a partnership for taxation purposes (see subsection 6(1)).

64. A syndicate is not a partnership if it only controls a stallion for use in servicing mares nominated by the syndicate members.

65. However, if the stallion is used to obtain service fees which are split among all of the syndicate members, the syndicate members are in receipt of income jointly and are a partnership for taxation purposes.

66. If the syndicate is involved in the breeding and/or racing of stallions and mares owned by the syndicate, it is possible that the syndicate members are carrying on a business as partners.

(iii) If the syndicate is a partnership for taxation purposes

67. If the syndicate is a partnership for taxation purposes it must lodge a taxation return.

68. In the normal situation, where the horse is owned by the syndicate members rather than the syndicate, but the syndicate receives service fees income jointly, the syndicate should lodge a taxation return returning the overs income. As the horse is not owned by the syndicate, the horse may not be "written down" in the live stock accounts or depreciation schedule of the syndicate. The individual syndicate members should include in their assessable income their interest in the partnership income. The income from "overs" is assessable when derived by the syndicate, not when distributed to syndicate members.

(iv) 'Leasing" of a part interest in live stock

69. In general, leasing of horses is acceptable for income tax purposes provided the lease agreement complies with the guidelines on genuine leasing arrangements outlined in Taxation Ruling IT 28 and related rulings. However, some syndicate arrangements are entered into to finance the acquisition of a part interest in a horse breeding, racing or stallion syndicate. They involve a series of so called lease payments, but are not true leases because the subject of the "lease" is a part interest in the syndicate horse.

70. A true lease of property requires, among other things, that the property be leased to one party or to parties in common. A "lease" of a part interest in a horse may not enable the "lessee" to acquire a possessory interest in the horse. In these circumstances, a lease does

not exist because the "lessee" acquires a chose in action and not a chose in possession.

71. In general, the taxation treatment of payments under agreements of this nature which create a chose in action is akin to the treatment of payments of principal and interest on a loan. Division 16E of the Act may apply to these arrangements in addition to the general income and deduction provisions of the Act. Broadly Division 16E applies to financial arrangements which create a contractual liability to make payments (other than periodic interest) over a period in excess of 13 months and where the sum of the payments exceeds the consideration given under the contract.

72. If the so called lease agreement is a chose in action and satisfies the definition of a "qualifying security" in Division 16E then the payments are subject to the application of subsections 159GT(1) and 159GT(3). These provisions in effect deny a deduction for the actual payments and allow deductions for the "interest" component of each payment to the "lessee". The interest component is assessable to the "lessor".

(f) Stallion service fee receipts

73. Income from the sale of stallion service fees is generally assessable when the stallion owner invoices the mares owner; normally following a positive pregnancy test of the mare, in accordance with the principles expounded in the case of *Arthur Murray (NSW) Pty Ltd. v F. C. of T.* (1965) 14 ATD 98; 114 CLR 314.

(g) Prepayments of stallion service fees

74. Generally speaking, stallion service fees fall due on a 45 day (thoroughbred) or 42 day (standardbred) positive pregnancy test. If stallion service fees are paid in advance, they may be allowable deductions subject to the provisions of Subdivision H of Division 3 of Part III.

75. Expenditure incurred on service fees that extend beyond 13 months will be subject to section 82 KZM and the deduction available is apportioned in accordance with the formula:

$$\frac{\text{Period of year}}{\text{Eligible Service Period}}$$

76. It should be noted, however, that prepayments of service fees to associates may not be allowed if the associate does not return the

assessable income in the year in which the income was received (section 82KK).

(h) Ruling requests

77. Taxpayers are reminded that if in doubt regarding the status of their activity or deductions etc. they should always request a Ruling from the Australian Taxation Office (ATO) to clarify the matter.

Date of effect

78. This Ruling applies 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 a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Whether the activities are a hobby or a business

79. The general rule that the racing of horses is not accepted as a business if it is not associated with breeding or training activities of the taxpayer is based on:

- The central importance of the motivation test and the likelihood that a hobby 'mentality' will be involved,
- The low probability of a profit,
- The element of chance involved, and
- Other 'anti-business' aspects of horse racing.

80. This was considered in *Case E22* 73 ATC 168 at 172; 18 CTBR (NS) *Case 75* at 598 where Taxation Board of Review No. 2 said:

> '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. Again from general knowledge, the cost of racing in most cases exceeds what is won and this is particularly so if the owner does not bet. The likelihood that racing will result in losses rather than profits tends against a ready inference that it is conducted as a business.'

81. Further in *Case M72* 80 ATC 497 at 507; 24 CTBR (NS) *Case 47* at 412, Member J.R. Harrowell of Taxation Board of Review No. 1 stated:

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

82. The major factor considered by the courts in deciding whether the racing of horses is a hobby or a business is whether the taxpayer has a 'hobby mentality'. No amount of system, repetition, success or scale of operations can overcome such a fact. If the taxpayer is predominantly racing horses for pleasure or out of an interest in the activity, rather than primarily as a business operation, it will not be a business.

83. Industry statistics show that only 5% of thoroughbred horses show a profit on the racetrack and it is difficult to envisage how racing could amount to a commercial activity.

84. It is also relevant to look at the extent to which racing is likely to reward skill and judgment or depend principally on chance. For example, in *Case C18* 71 ATC 77; 3 CTBR (NS) *Case 19*, an accountant's claim that his motor racing activities amounted to a business enterprise was rejected. The fact that his participation in the activity was incapable of providing any profit unless he was successful to an improbable degree was considered to be repugnant to any normal concept of business.

85. To date there have been only three reported cases in Australia where the racing of horses was held to be a business - see *Case Q73* 83 ATC 368; 27 CTBR (NS) *Case 4*, *Case D7* (1953) 4 TBRD 35 and *Case X28* 90 ATC 276; AAT *Case 5736; 21 ATR 3268*. In all of these cases, the racing was either associated with the concurrent breeding of horses or the taxpayer was also a horse trainer.

86. Nevertheless, there may be exceptions to this general rule and the taxpayer's operations may be accepted as a business. It is possible for the activities of a taxpayer to be 'so considerable, systematic and organised that it could be said to exceed those of a keen follower of the turf and amount to the carrying on of a business.' (*Martin v. F.C. of T. (1953) 90 CLR 470; 10 ATD 37,226).*

Live stock or plant

87. 'Live stock' is defined in subsection 6(1) to 'not include animals used as beasts of burden or working beasts in a business other than primary production'. Subsection 6(1) also defines 'primary production' to mean 'production resulting directly from the maintenance of animals or poultry for the purpose of selling them or their bodily produce, including natural increase'. 'Trading stock' is defined to include 'anything produced, manufactured, acquired or purchased for purposes of manufacture, sale or exchange, and also includes live stock'.

Examples

88. It should be noted that the examples provided are illustrative only of the general approach to be taken by the ATO in each case, and that each case needs to be looked at on its own particular facts.

Whether a hobby or business

Example A:

89. A taxpayer races horses and intends to breed the racehorses at a later date. This taxpayer is not considered to be combining racing with a breeding business. Accordingly unless the tests stated in paragraph 6 are satisfied, the ATO will consider that the taxpayer is not in the business of racing horses.

Example B:

90. A racehorse owner bought 47 and sold 24 horses within 6 years, and raced his horses on the advice of his trainer who also decided when to spell them etc. He had four potential broodmares in training and two brood mares with foals at foot and in foal again. No progeny had been sold. When asked about one of the foals, the taxpayer said that he intended to race it. His activities were held to represent no more than a hobby and not to constitute a business conducted for a profit. (*Case E22* 73 ATC 168, 18 CTBR (NS) *Case 75*)

Example C:

91. Over several years a taxpayer acquired 18 horses for a total of $16,000, including 8 mares. Most of the horses were being used for racing. A total of 9 foals were born, but none were sold as yearlings. 4 horses were sold, including 2 mares. Although the taxpayer sold and lost some mares, they were not replaced. The taxpayer is not considered to be in the business of breeding horses.

Calculation of Special Closing Value

Example D:

92. A male horse was acquired under a contract on 1 July 1993 for $6,000. It was used for different purposes during the year as follows:

(i) from 1/7/93 to 1/9/93 for racing purposes

(ii) from 2/9/93 to 30/6/94 for breeding purposes

For the purposes of calculating the special closing value, the **reduction amount** will be calculated according to the formula in subsection 32A(8).

The **base amount** is the lesser of the cost price or the depreciated value at the time the horse became the live stock of the taxpayer.

The depreciation for the period based on the period from 1/7/93 to 1/9/93 (63 days) is calculated as follows:

$$\$6,000 \times 10\% \times \frac{63}{365} = \$103.56$$

Therefore the **depreciated value** (and the base amount) as at 1/9/93 would be:

$$\$6,000 - 103.56 = \$5896$$

The number of **holding days in the year of income** is the period from 2/9/93 to 30/6/94 (based on subsection 32A(9)) ie. 302 days.

Assuming the taxpayer's **nominated percentage** to be 25%, the reduction amount is calculated using the formula in subsection 32A(8):

$$\$5896 \times 25\% \times \frac{302}{365} = \$1220$$

Therefore, the **opening value** (paragraph 32A(7)(b)) is the lesser of the cost price of the horse or its depreciated value. In this case the opening value is the depreciated value which is $5,896

The **special closing value** (ie., opening value less reduction amount) is:

$$\$5,896 - 1220 = \$4676$$

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- capital gains tax on racehorses
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- live stock
- stallion service fees
- syndicated horses
- valuation of live stock

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- ITAA 36
- ITAA 51(1)
- ITAA 51(2)
- ITAA 54
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- ITAA 82KZM
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- ITAA 160Z(7)
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