

QUESTIONS WE'VE BEEN ASKED

How to determine the cost price of bloodstock

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QB 21/09

This Question We've Been Asked outlines how to determine the cost price of bloodstock. It is relevant to a person who has a bloodstock breeding business.

Key provisions

Income Tax Act 2007 – ss EC 2, EC 3, EC 38 – EC 45, EZ 5 - 6 and s YA 1

QB 21/09 replaces: "Bloodstock Cost Determination", Public Information Bulletin 166, November 1987 (pages 6,7) and Public Information Bulletin 175, July 1998 (page 8).

Question

How is the cost price of bloodstock determined?

Answer

At the end of each year bloodstock must be valued at its cost price less any reduction applying for that year. Given this, when valuing bloodstock for tax purposes, the overarching principle is that, wherever possible, actual cost should be used as the basis of valuation. Where the actual cost is not known with certainty, such as with home-bred progeny, a consistent means of establishing the cost price of that progeny is still required. For home-bred progeny, the cost price should reflect the cost to the breeder of producing the foal.

Key terms

Bloodstock means a horse that is a member of the standardbred or thoroughbred breed of horses; and includes a share or interest in such a horse.¹

Cost price means the cost associated with purchasing or producing bloodstock. All components of cost price are exclusive of GST.²

Reduction means the amount the cost price of the bloodstock is reduced by at the end of the income year, applicable to bloodstock aged 2 years or older that have been acquired for breeding.³ This is also referred to as the "specified write down".

Explanation

1. This Question We've Been Asked outlines how to determine the cost price of bloodstock; including when progeny is home bred, when the stallion is owned by the

¹ s YA 1 – definitions "bloodstock", Income Tax Act 2007.

² s YA 1 – definitions "cost price", Income Tax Act 2007.

³ s EC 41, EC 42, EZ 5, or EZ 6, Income Tax Act 2007.

taxpayer, and when a mare is purchased in-foal. It replaces the obsolete Public Information Bulletin (PIB) items *Bloodstock Cost Determination* in PIB 166 and PIB 175.

What this QWBA covers

2. This QWBA sets out how to determine the cost price of bloodstock in the following situations:
 - bloodstock that has been purchased – excluding in-foal mares
 - bloodstock that is home bred – including when the stallion used is owned by the breeder, or when the stallion or mare has been leased
 - bloodstock that has been purchased as an in-foal mare.
3. It also clarifies how unborn foals are to be treated at balance date.

Background

4. Bloodstock, whether purchased or homebred, is initially required to be valued at its cost price.⁴ In either case this will be the actual cost incurred in acquiring the animal. Where bloodstock is home-bred, the outlay or overheads incurred by the breeder in producing the progeny should be used to establish its cost price.⁵
5. It is worth noting that although some items of expenditure need to be attributed to the foal to ascertain its cost price, the expenditure remains deductible to the taxpayer where it meets the ordinary tests for deductibility.

Unborn foals at balance date

6. Unborn foals are not required to be valued at balance date.⁶ This is so even where a mare is purchased by a breeder in-foal. See [13]-[23] for further discussion regarding the treatment of in-foal mares.

⁴ ss EC 39(3) and EC 44, Income Tax Act 2007.

⁵ TRA *Case S12* (1995) 17 NZTC 7,102.

⁶ This replaces advice previously given in Public Information Bulletin 175, July 1998 (at page 8).

Purchased bloodstock – excluding in-foal mares

7. Bloodstock that is purchased should be valued at its acquisition cost plus the cost of getting the horse to its new location. This value may include items such as the acquisition cost, vet and valuation fees, transportation, and travel insurance.

Example

Example 1 – Purchased bloodstock

Henry is a breeder who purchases a 2 year old filly for \$20,000. He pays \$300 for transport and another \$1,250 for vet and valuation fees. He also pays an additional \$150 for travel insurance.

The total cost price of the filly is \$21,700.

Home bred Progeny

8. Foals are valued at their cost price on the breeders' first balance date after they are born.⁷ Any expenditure incurred in raising a foal after this first balance date is not required to be added to the cost price of the foal.
9. As servicing costs are incurred in the production of assessable income, they are fully deductible in the year in which the expenditure is incurred (as noted at [5]). This applies even if the foal dies either prior, or subsequent to its birth.
10. The cost price of all home bred progeny is made up of the following components:⁸
 - the stallion service fee paid, and
 - any reduction attributable to the mare in the year of foaling, and
 - any foaling, weaning (and vet fees incurred in rearing the foal) between the birth of the foal and the first balance date.

⁷ s EC 44, Income Tax Act 2007.

⁸ TRA *Case S12* (1995) 17 NZTC 7,102

Where a breeder employs external parties to undertake the foaling and weaning of progeny (as well as any associated veterinary needs), the cost of these activities is required to be attributed to the cost of the foal.

Where the foaling and weaning of progeny is undertaken by the breeder personally or the breeder's employees, the cost (or a reasonable estimation of the cost) to the breeding business of these activities should be attributed to the cost of the foal.

Where external parties are not employed, it is acknowledged that in some cases, arriving at the exact cost to the breeder of these activities (or even a reasonable estimate of that cost) may be difficult. In view of this, the Commissioner will accept a *de minimis* amount of \$500 to be used as an acceptable approximation of these foaling and weaning expenses (vet fees will invariably be charged by an external party and are therefore not included in this *de minimis* figure).

Stallion owned by breeder

11. Where the stallion is owned by the breeder the service fee component of a foal's cost can be calculated in one of the following two ways (the breeder can choose which option best suits them):
 - the service fee usually charged by the breeder to an arms-length party (this represents the "economic cost" of the service to the breeder, being the service fee forgone to service their own stock), or
 - the direct costs of the stallion in the year of service
the number of mares servicedwhere the direct costs are an accumulation of insurance, external service costs (such as vet fees), and the stallion's reduction in the year of service.

Leased bloodstock

12. If a mare has been leased, there will be no reduction available to the breeder leasing that bloodstock that could be attributed to the cost of any progeny. In this circumstance, the cost price of the progeny must, instead, include any lease fee paid in the year of foaling.
13. If a breeder that is leasing a stallion wishes to use the **direct costs** formula at [11], that breeder will need to include all lease payments made in the year of service as part of **the direct costs of the stallion in the year of service** in the calculation. This expense replaces the reduction of the stallion in the year of service in the calculation.

Examples

Example 2 – Homebred progeny, service fee paid for use of stallion

Margaret pays a service fee of \$12,500 to have one of her mares serviced. At the time the foal is born the mare's cost price is \$18,000 and the mare is 5 years old. A foaling fee of \$400, a \$350 weaning fee and vet fees of \$400 are also incurred during the year.

The cost price of the foal is as follows:

\$12,500	stallion service fee
\$ 4,500	reduction on mare in year of foaling ⁹
\$ 750	foaling and weaning fees
<u>\$ 400</u>	vet fee
\$18,150	total cost price

Example 3 – Homebred progeny, stallion owned by breeder

Hamish is a breeder who owns a 6-year old stallion; the service fee he usually charges is \$4,000. Hamish decides to service three of his mares with the stallion, which also serviced 12 mares from third parties. The stallion's vet fees for the year come to \$300 and his insurance is \$2,700, the reduction available in that year is \$0 (the stallion has already been fully reduced and has a closing value of \$1, so there is no reduction in the year of service).

Market value

Per [11], if Hamish chooses the first option, the service fee component of any resulting foals would be \$4,000.

Direct cost

Using the second option, the service fee component would be:

⁹ s EC 42, Income Tax Act 2007

$$\frac{\text{vet fees + insurance + reduction in year of service } (\$300 + \$2,700 + \$0 = \$3,000)}{\text{number of mares serviced (15)}}$$

The service fee component of any resulting foals would be \$200.

Example 4 – Home bred progeny, mare leased

Thorough Stud Limited leases a mare. For the year of foaling the mare's lease fee payments amount to \$7,200. Thorough Stud Limited also pays a stallion service fee of \$6,000. Up until the first balance date, the vet and foaling fees were incurred totalling \$1,200.

The cost price of the foal is as follows:

\$6,000	stallion service fee
\$7,200	mare's lease fee
<u>\$1,200</u>	foaling and vet fees
\$14,400	total cost price of the foal

The purchase of in-foal mares

14. The usual gestation period for a foal is a little over 11 months. It is therefore likely that a mare purchased in-foal will still be in-foal on the first balance date with the new owner. This being so, for mares purchased in-foal there needs to be two ways of determining the cost price, dependent on whether the foal is born before the first or second balance date of the new owner.
15. Irrespective of the year in which the foal is born, on the first balance date after its birth it is required to be valued in the manner described at [10].

Service fee component of a mare purchased in-foal

16. As previously discussed, one of the components of a foal's cost is the stallion service fee. Where the mare has been purchased in-foal, the service fee would have been paid by the mare's previous owner. Generally, the details of this service fee (or the usual service fee charged by the stallion owner) should be easily obtainable. This service fee will make up a part of the total purchase price of the mare but will need to be separated out at the time the cost price of the foal is determined. This is on the basis that the service fee component of the mare's purchase price is the amount of the premium paid for the unborn foal (or at least a reasonable proxy for that premium).

17. In the unlikely event that the service fee component is not able to be ascertained, the Commissioner will accept an apportionment of the acquisition price between the mare and the foal, based on the recommendation of a recognised bloodstock valuer.
18. If the amount of the service fee is the same or more than the total acquisition price¹⁰ of the in-foal mare, then the mare should be valued at \$1, (the lowest value possible under current legislation).¹¹ The remainder of the acquisition price will be attributed to the foal's cost price. This recognises the reality that, in this circumstance, the price paid was to acquire the foal and not the mare.

Foal born in year 1

19. If the foal is born before the first balance date of the new owner, the service fee component of the acquisition price for the mare would be allocated to the foal. The service fee is deducted from the acquisition price of the mare before applying any reduction to the mare's cost price for that year.
20. The foal's cost price will be determined using the method already discussed in [10] and Example 2.

Foal born in year 2

21. If the mare is still in-foal at the new owners' first balance date, the cost price of the mare still needs to be established. In this scenario this would be the total acquisition cost of the mare. The reduction applicable to the mare in that year would then be applied to this total acquisition price.
22. In the second year of ownership, if no live foal results from the pregnancy, the mare will remain valued at this written down amount and the year two reduction applied to it.
23. When the foal is born in the second year, a cost price will need to be determined for both the mare and the foal at the breeder's balance date for that year. To do this, the service fee component needs to be removed from the mare and attributed to the foal.

¹⁰ Inclusive of any costs associated in acquiring the mare, per [7].

¹¹ s EC 45, Income Tax Act 2007.

This lowers the mare's value (by the amount attributed to the foal). The year two reduction to the mare can then be applied to this resulting lowered value.

24. The foal's cost price will be comprised of this service fee component, the year two reduction on the mare and any foaling, weaning and vet fees incurred (as discussed at [10] and Example 2).

Example

Example 5 - Mare purchased in-foal

A 4 year old mare was purchased in-foal for \$20,000 – this includes transportation and insurance. The service fee paid for the mare by the previous owner was \$5,000.

Scenario A - Mare foals in year 1 (before the first balance date of the new owner)

Mare:

Cost price: \$20,000 less the service fee of \$5,000 – which is attributed to the cost price of the foal = \$15,000

Reduction: cost price of mare ÷ (9 – age of mare)

\$15,000 divided by (9-4) = \$3,000

Closing value: (cost price – reduction) = \$12,000

Foal:

Cost price (closing value): \$3,000 (reduction from mare) + \$5,000 (service fee) + \$1,000 (foaling and weaning fees) + \$500 (vet fees) = \$9,500.

Scenario B - Mare foals in year 2 (after first balance date of the new owner)

Year 1

Mare:

Cost price: \$20,000

Reduction: cost price of mare ÷ (9 – age of mare)

\$20,000 divided by (9-4) = \$4000

Closing value (cost price – reduction) = \$16,000

Year 2

Mare:

Opening value in year 2 (from closing value in year 1): \$16,000 less the service fee of \$5,000 (which is attributed to the cost price of the foal) = \$11,000

Reduction: Opening value of mare (less service fee reduction) ÷ (9 – age of mare)

$\$11,000 \div (9 - 5) = \2750

Closing value: (cost price – reduction) = \$8,250

Foal:

Cost price (closing value): \$2,750 (year 2 reduction from mare) + \$5,000 (service fee) + \$1,000 (foaling and weaning fees) + \$500 (vet fees) = \$9,250.

References

Legislative References

Income Tax Act 2007, ss EC 41, EC 42, EC 45, YA 1 “bloodstock” and “cost price”.

Case References

TRA Case S12 (1995) 17 NZTC 7,102

About this document

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