EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

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QUESTIONS WE'VE BEEN ASKED > GENERAL ISSUES

How to determine the cost price of bloodstock

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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 44 and YA 1

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

Question

How do you determine the cost price of bloodstock?

Answer

At the end of each year bloodstock must be valued at its cost less any reduction applying for that year. Given this, the overarching principle is that, wherever possible, actual cost should be used as the base. Where the actual cost is not known, such as with home bred progeny, a consistent means of establishing the cost price of that progeny is still necessary. 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 "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 taxpayer, and when a mare is purchased in-foal. It replaces the obsolete Public Information Bulletins (PIB) items *Bloodstock Cost Determination* in PIB 166 and PIB 175.

[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

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
   - When a 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. Because bloodstock is required to be valued at cost price, it is necessary to establish the cost price of bloodstock that is either purchased, or home bred. In either case this will be the actual cost incurred in acquiring the animal. The cost price should be reflective of the actual cost incurred for the bloodstock, so 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.[4]
5. It is worth noting that although some items of deductible expenditure will 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. Foals are valued at cost price at the end of the first balance date after they are born.[5]
7. As servicing costs are incurred in the production of assessable income, then as noted at [5] they are fully deductible in the year in which the expenditure is incurred. This applies even if the foal dies either prior, or subsequent to its birth.

[4]TRA *Case S12* (1995) 17 NZTC 7,102
[5]TRA *Case S12* (1995) 17 NZTC 7,102

Purchased bloodstock – excluding in-foal mares

8. All bloodstock that is purchased should be valued at its acquisition cost plus the cost of getting the horse to its new location. This includes such items as acquisition, vet and valuation fees, transportation, and additional 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 $1250 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

9. The cost price of all home bred progeny is made up of the following components[6]

- the stallion service fee paid
- any reduction attributable to the mare in the year of foaling
- any foaling, weaning and vet fees incurred between the birth of the foal and the first balance date (any fees incurred after the first balance date would not be a component of the foal's cost price).

Stallion owned by breeder

10. Where the Stallion is owned by the breeder the service fee component can be calculated in one of the following two ways (the breeder can choose which option best suits them):

[6] TRA *Case S12* (1995) 17 NZTC 7,102

- 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
- $\frac{\text{The direct costs of the stallion in the year of service}}{\text{The number of mares serviced}}$

Where 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

11. Where a stallion or mare has been leased, there would be no reduction available to the breeder. In these instances, the cost price of the progeny would include the lease fee paid in place of the reduction component[7].

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 five years old. A foaling fee of $550, a $500 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[8]
$ 1,050	Foaling and weaning fees
$ 400	Vet fee
$18,950	Total cost price

[7] If a stallion is leased, the breeder would work out the service fee component as if they owned the stallion, with the lease fee replacing the reduction component of the *direct costs* in the formula at [10] (if that option is chosen).

[8] s EC 42, Income Tax Act 2007

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

If he 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:

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

= $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 foal has vet and foaling fees totalling $1,200.

The cost price of the foal is as follows:

$6,000	Stallion service fee
$7,200	Mare's lease fee
$1,200	Foaling and vet fees
$14,400	Total cost price

Purchased in-foal mares

12. 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 at the first balance date with the new owner. Therefore, there are two different ways of determining the cost price of a mare

purchased in-foal, dependent on if the foal is born before the first or second balance date of the owner.

Service fee component of mare purchased in-foal

13. Generally, the service fee paid by the previous owner (or the market value of the service fee for the stallion used) should be easily obtainable. This 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 is the amount of (or at least a proxy for) the premium paid for the in-foal mare.

14. 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 registered valuer.

15. If the amount of the service fee is the same or more than the total acquisition price[9] of the in-foal mare, then the mare should be valued at a $1, (the lowest value possible under current legislation)[10] 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

16. If the foal is born before the first balance date, the service fee component of the acquisition price for the mare would be allocated to the foal. The service fee would be deducted from the acquisition price of the mare before applying any reduction to the mare's cost price for that year.

17. The foal's cost price will be determined using the method already discussed in [9] and Example 2.

[9] Purchase price plus any costs associated in getting the mare to the breeder

[10] s EC 45, Income Tax Act 2007

Foal born in year 2

18. If an in-foal mare is still pregnant at the end of the first balance date, the cost price for the mare still needs to be established. In these instances, this would be the total acquisition cost of the mare (including any service fee component). The year one reduction would then be applied to this cost price.

19. 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.

20. In the second year, once the foal is born, a cost price will need to be determined for both the mare and the foal.

21. To do this, the service fee component would be removed from the mare and attributed to the foal. This would lower the cost price of the mare by the amount attributed to the foal. The year two reduction to the mare would be applied to the resulting cost price (after the service fee has been removed).

22. The foal's cost price would comprise of the service fee component, the year two reduction on the mare and any foaling, weaning and vet fees incurred (as discussed at [9] and Example 2).

Examples

Mare purchased in-foal

A 4-year-old mare was purchased in-foal in year 1 for $20,000 – this includes transportation and insurance. The service fee paid for the mare was $5,000 (incl. in the purchase price).

Scenario A - Mare foals in year 1 (before first balance date)

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 broodmare ÷ (9 − age of broodmare)

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)

Year 1

Mare:

Cost price: = $20,000

Reduction: cost price of broodmare ÷ (9 − age of broodmare)

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

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

Year 2

Mare:

Cost price: $16,000 less the service fee of $5,000 (which is attributed to the cost price of the foal) = $11,000

Reduction: cost price of broodmare ÷ (9 − age of broodmare)

11,000 divided by (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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