TAX CONSIDERATIONS CHECK LIST
Is your horse racing activity a business?

AMERICAN HORSE COUNCIL

Possible Tax Benefits For Horse Owners

If your horse operation is a business, then consider available deductions:

A. 100 percent **bonus** depreciation – **deduct the cost of a horse and/or certain other property in full during the year that it is placed in service.**

B. Three-year depreciation for racehorses available through 2020.

C. Seven-year depreciation – broodmares and breeding stallions less than 144 months of age.

D. Deduction of **"ordinary and necessary"** expenses. In the tax world "ordinary and necessary" means "reasonable and helpful." And "ordinary and necessary" expenses are currently deductible in full in the year that they are incurred.

These tax benefits can be very useful, but they are **only** available to activities that are operated primarily **for profit**. The IRS determination is whether the activity is profit-motivated.

The overall question is whether your **subjective primary intent** is to make a profit.

If profit is your primary motive, then you have a business and business tax treatment, including the ability to offset losses in your horse business against other income as appropriate. But if profit is not your primary motive, then your horse racing activity is not a business, and business treatment for tax purposes is not appropriate. If profit is your primary motive, then at a practical level, the question is: How do you prove your intent to the IRS or other taxing authority.

The IRS has a nine factor test to determine a Taxpayer's state of mind related to intent to run a business:

1. <u>Manner in which Taxpayer carries on activity.</u> Under this factor, keep books and records like you use in your other business. Review them and use to make changes to improve your business. Having a separate bank account for your horse business is another essential basic step. Another major element evaluated under this factor is: **Have there been any major changes in the operation to improve profitability or limit losses?**

2. <u>Is there an expectation that assets, including land, will increase in value?</u> If so, this suggests a profit motive. This is factor number four of the nine, but it is the second most important in helping the IRS understand that a horse activity is a business. Have your horses appreciated? Written appraisals will help you prove appreciation of your horses. Do you have a farm or ranch? If so, IF you purchased it for the purpose of operating a horse business, it is an asset of the horse business and therefore the appreciation of the land counts in favor of your business.

3. Expertise of taxpayer or advisors. Is the racehorse owner an expert in racing, or the care of horses? Does he or she regularly hire breeding, racing or business experts to advise the owner concerning the activity? The more expertise, the better.

4. How much time does the racehorse owner spend engaging in racing? Again, the more the better. A contemporaneously kept daytimer or other written journal is the best way to prove the time that you have spent. But there are other ways as well, like credit card receipts or other records.

5. Does the horse owner conduct similar activities while turning a profit? Can you show that your operating methods, e.g., buying yearlings at Keeneland, are similar to successful businesses? The more like businesses that are successful, the better.

6. How many years have you operated without making a profit? Initial start-up losses are expected, especially in racing, but if they're ongoing past a start-up period, unless there are excuses or other reasons, then it may not be considered a business.

7. Do you derive substantial income from other sources? The more you make, the closer the IRS will look. The case law says that the presence of other income poses the question whether the owner is profit motivated, but it does not answer that question.

8. Be prepared to show an auditor that **it is possible to make large profits in the horse business.**

PRESUMTIONS

There are two “presumtions that can be involved.

A. General Presumption. If you have two profit years in a seven year period, then from the end of the second profit year to the end of the seventh year after the first profit year, you will be presumed to be in business for a profit.

The American Horse Council appreciates the helpful insights from Paul Husband, Esq., related to tax benefits that may accrue to racehorses.

B. Special Presumption. During your first seven years of business, you can file an “election to defer determination”, and if you file that election, and you have a profit during any two years of the first seven years, then you will be presumed to be in business for profit for ALL seven years. But there is a price to be paid. If you file the election to defer determination, you must also extend the statute of limitations from the usual three years to seven years. You are also assuring that you will be audited at the end of year seven, with seven years in issue.

The IRS, when examining a new horse business will sometimes offer to discontinue the audit IF the horse business owning taxpayer will make the election to defer determination. Some experienced horse tax professionals recommend that the special presumption NEVER be elected because it opens up the statute of limitations.

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