

## Ruling Compendium – for Rulings and Determinations

A compendium of responses to the issues raised by external parties to TR 2007/D9 (referred to as the draft Ruling, all references to 'the Ruling' in the response column are to the final Taxation Ruling TR 2008/2)

[Note: All references are to the *Income Tax Assessment Act 1997*, unless otherwise stated]

*Generally, if an issue has been raised by a number of different entities, it will be included only once.*

### Summary of issues raised and responses

Issue No.	Issue raised	Response
1	<p>Stated that the draft Ruling reflects the law and will provide assistance to those involved in the racing, training and breeding of horses in deciding whether they are carrying on a business for tax purposes. The draft ruling appears to confirm and reinforce existing practice in this regard.</p> <p>The general consequences which follow the determination of a business or non-business status of horse-related activities are also well covered.</p>	Acknowledged.
2	<p>Suggested that the application of the capital gains and depreciation provisions need further explanation in a plain English manner early in the Ruling rather than in the appendices.</p>	<p>Paragraphs 14 to 25 of the Ruling, including Tables 1 to 3, set out the essential application of the capital gains tax (CGT) and uniform capital allowances (UCA) provisions to horse related activities.</p>

3	<p>Query as to why the draft Ruling does not cover the following issues:</p> <ul style="list-style-type: none"> <li>• foal share arrangements;</li> <li>• leasing arrangements relating to the breeding of horses or syndicate arrangements generally; and</li> <li>• isolated profit-making transactions involving horses.</li> </ul>	<p>Paragraph 4 of the Ruling states that it does not deal specifically with the situations listed. However, it is acknowledged by the Tax Office that further guidance is required on these important industry issues.</p> <p>As such, these issues are currently being considered by the Tax Office with a view to providing further guidance, which may include guidance by way of taxation determinations or a public ruling.</p>
4	<p>Stated that there was no mention in the draft Ruling as to how the law applies to the industry of 'horse trading' and whether racing is integral to that activity.</p>	<p>As noted in paragraph 2 of the Ruling, the Ruling does not attempt to provide a comprehensive examination of every income tax issue that may potentially arise. However, whether a business of horse trading is being carried on will be a question of fact, depending on the circumstances of each case.</p> <p>Although the business of horse trading is referred to only in paragraph 16 of the Ruling, the discussion of the general indicators of a business as expressed in paragraph 9 of the Ruling (reproduced from Taxation Ruling TR 97/11) will be applicable and will provide taxpayers with the assistance to determine whether their horse trading activities constitute the carrying on of a business.</p> <p>In addition, the discussion in the Ruling with respect to racing as an integral part of a training and/or horse breeding business will be relevant in determining whether racing is an integral part of a horse trading business being carried on by an entity.</p>

5	Stated that the recent Administrative Appeals Tribunal (AAT) decision of <i>MR &amp; SL Block v. FC of T</i> , <sup>*</sup> ( <i>Block</i> ), should be referred to and discussed.	The decision does not provide any general principle in addition to the general indicators and specific industry factors listed in the Ruling but it does confirm the relevance of these indicators. The Ruling includes a reference to this decision and the discussion in the Ruling confirms that the Tribunal: <ul style="list-style-type: none"><li>• considered a number of the relevant indicators such as the purpose and prospect of profit and the scope and nature of the activities undertaken in reaching its decision;</li><li>• considered the existence of losses as well as the reason for them; and</li><li>• implicitly accepted that racing activities were an integral part of the horse breeding business in that case.</li></ul>
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<sup>\*</sup> [2007] AATA 1897; 2007 ATC 2735.

<p>6</p>	<p>There should be recognition that all individuals/entities are 'carrying on business' irrespective of size or scale of operations. The majority of industry participants are involved in small or medium sized business undertakings/entities irrespective of entity structure. The majority are sole traders or partnerships. By necessity, they function in our business in association with undertaking other employment of a professional or trade occupation. This is a fundamental premise to the functioning of the Racing Industry as a whole where often the returns do not equal the recovery of costs.</p> <p>It is considered the concept of carrying on a business should be judged by the person/entity in their own terms with the intention of making a profit and therefore assessable income. Consideration of matching income/revenue against expenditure of varying types in a specialised industry such as the racing industry are fundamental to all businesses. Many commercial and environment conditions impact on this equation as they do in all primary industries, such that business outcomes cannot be accurately predicted.</p> <p>The exercising of judgement is the essence of carrying on business. It is also only after completing a transaction that a profit or loss after the assignment of relevant costs/deductions occurs. Importantly, clarity of this transaction for taxation can be assisted with the Australian Taxation Office providing relevant</p>	<p>Whether a business is being carried on will be a question of fact that will depend on the circumstances of each case and the Ruling sets out the factors that are relevant in deciding that question. Scale of activities and the intention and prospect of making a profit are significant considerations in that decision.</p> <p>The first sentence of paragraph 11 of the Ruling notes that:</p> <p style="padding-left: 40px;">The most important point is that the 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.</p> <p>It is therefore not possible to provide a checklist or template to determine if a business is being carried on. However, a taxpayer may apply to the Commissioner for a private ruling on the way in which the Commissioner considers a relevant provision applies or would apply to the taxpayer in relation to a specified scheme.</p>
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	<p>indicators like the Product Ruling mechanisms. This would assist our industry to have valid and up to date direction. These could be communicated through the Australian Taxation Office's website and our Industry websites similar to the excellent co-operation undertaken at the time of the introduction of GST utilising seminars etc.</p> <p>A Working Party between the Australian Taxation Office and the Horse Industry should be established to construct an agreed template of identifying Pre-Business Evaluation. This mechanism will then allow all to identify established criteria as to whether a business operation is acceptable or not at an early pre-evaluation time.</p>	
7	<p>Stated that there is no judicial authority for the specific industry factors listed in paragraph 35 of the draft Ruling being included in the criteria for determining whether horse breeding activities amount to the carrying on of a business.</p>	<p>Paragraph 35 of the Ruling confirms that it is a question of fact as to whether the breeding of horses amounts to the carrying on of a business.</p> <p>Paragraph 36 of the Ruling states that the general indicators as expressed in Taxation Ruling TR 97/11 (as reproduced at paragraph 9 of the Ruling) will be relevant to determine whether a business is being carried on. These indicators of whether a business is being carried on are drawn from relevant court and tribunal decisions</p> <p>Paragraph 37 of the Ruling (formerly paragraph 35 of the draft Ruling) does no more than to identify the industry specific factors that may be relevant when considering the general indicators. In a number of cases where a decision was made as to whether an entity was carrying on a business of horse breeding, the specific industry factors listed were referred to as evidence of a business and considered by the courts in making their final decision.</p>

8	<p>Suggested that the draft Ruling provide further guidance on what the ATO means by:</p> <ul style="list-style-type: none"><li>• the 'quality' and 'number' of horses; and</li><li>• the notion of 'regularly', given that mares should only be serviced every two years.</li></ul>	<p>As a result of industry consultation prior to the issue of the draft Ruling, it was decided that the draft Ruling would emphasise that whether a business was being carried on was a question of fact that depends upon the circumstances in each case. The Ruling highlights the general indicators of carrying on a business (paragraph 9) and refers to the relevant factors specific to the horse breeding industry (paragraph 37).</p> <p>The Ruling is not prescriptive about factors such as numbers or business practices to avoid the application of such factors as a hard and fast rule rather than as a guide.</p> <p>A specific practice such as regularity of service cannot be prescribed but is relevant as part of the total circumstances to be examined in deciding if a business is being carried on. The servicing of mares is required for a horse breeding business to exist. Industry standards are to be taken into account including the effect of unexpected events such as injury, death, drought or floods. To ensure that the emphasis remains on an examination of the facts in each circumstance, the word 'regularly' has been deleted from the third dot point in paragraph 37 of the Ruling.</p>
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9	<p>Racing is a rural livestock industry and the use of a primary producer approach should be broadened to include all breeding as a fundamental premise or condition. In this way, the process of breeding horses which is a complex and strategically difficult business transaction often requiring professional advice for genetic matching of sire and dam. Again, timing is a difficult consideration because of the life cycles of the horse.</p> <p>Importantly, all participants should be allowed to spread costs over time to match against revenues obtained. Could consideration be given to spreading the revenues? This is a proposition for review because the nature of our industry rewards excellence in performance through stake money earned or sale prices achieved.</p>	<p>As discussed in the Ruling, decisions of the Board of Review, the Tribunal and Courts demonstrate the difficulties a taxpayer will have in establishing that they conduct horse racing as a stand-alone business.</p> <p>Should racing activities amount to a stand-alone business, it will not be a business of primary production and averaging will not be available for the income of the business.</p> <p>The Ruling is not able to address issues that require changes to the law.</p>
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10	<p>The draft Ruling does not specifically deal with managed investments in the horse industry. It is understood that in recent years, managed investment schemes in the horse industry have been reviewed by the Australian Securities and Investment Commission (ASIC). It is understood that ASIC has required the promoters to treat investments in the horse industry like any other managed investment scheme, requiring product disclosure statements, etc. This indicates that ASIC considers investments in the horse racing industry to be like any other investment activity. It is suggested that the final ruling considers the implication of managed investment schemes.</p> <p>Also, it is advised that some of the managed investment schemes in the horse industry are in trust structures. The draft Ruling does not deal with how investments in a horse through trust structures are to be treated for tax purposes.</p>	<p>The current Tax Office view on stallion syndicate arrangements can be found in Taxation Ruling TR 93/26.</p> <p>However, this issue is currently being considered with a view to providing further guidance, which may include guidance by way of taxation determination or a public ruling.</p>
11	<p>Suggested that the statement in the 3<sup>rd</sup> dot point in paragraph 12 of the draft Ruling that CGT event K7 may apply requires further explanation for uninformed readers and should be expanded with an example where the non-business horse is sold.</p>	<p>The relevant dot point (dot point 5) of paragraph 12 of the Ruling has been amended to provide further clarification.</p> <p>However, it is noted that paragraphs 14 to 25 of the Ruling, including Tables 1 to 3, set out the essential application of the CGT provisions to horse related activities.</p> <p>Also, Example 2 of the Ruling addresses the CGT issues arising from the sale of a horse where a business is not being carried on.</p>

12	Suggested that terms such as 'livestock' and 'trading stock' (referred to in paragraphs 15 & 16 respectively of the draft Ruling) are used interchangeably by primary producers and a reference should be made to the explanation at paragraphs 113 to 117 of the draft Ruling.	Paragraph 16 of the Ruling has been amended to insert a reference to paragraphs 122 to 134 of the Ruling for further explanation of the terms 'livestock' and 'trading stock'.
13	Query in respect of the reference to \$10,000 or less in paragraph 23 of the draft Ruling – does it mean that a capital gain will be disregarded if my cost is less than \$10,000 as the cost of the horse is split among others. Therefore, each person's cost is below \$10,000 and no capital gains tax is payable.	<p>This will depend on the circumstances of each case and whether the assets are partnership assets or an asset that is merely co-owned. Paragraphs 98 and 99 of the Ruling provide further discussion on this issue and explains that where a depreciating asset is co-owned and not a partnership asset, then each co-owner must treat their depreciating asset (their interest in the underlying asset) in accordance with their own tax profile.</p> <p>Please note that the Ruling does not deal specifically with syndicate arrangements generally and the issue is currently being considered with a view to providing further guidance, which may include guidance by way of taxation determinations or a public ruling.</p> <p>The current Tax Office view on stallion syndicate arrangements can be found in Taxation Ruling TR 93/26.</p>
14	Query in respect of paragraph 25 of the draft Ruling which states that the horse is to be installed ready for use – when will this occur?	<p>Paragraph 95 of the Ruling explains that a depreciating asset starts to decline in value from when its start time occurs (section 40-60). The start time is when the entity first uses it or has it installed ready for use for any purpose. The start time for a horse will be when it is acquired or when it is born. There is a footnote to this paragraph that states that there is a different start time under subsection 40-60(3) in certain circumstances.</p> <p>A reference to paragraph 95 of the Ruling has been inserted into paragraph 25 of the Ruling.</p>

<p>15</p>	<p>Stated that the Tax Office view that a stand-alone horse racing business will be rare does not take into account factors such as increased prize money and the increasing professionalism of the industry.</p> <p>In addition, a query as to what circumstances will the Tax Office consider that a stand-alone horse racing business exists and can an example be included in the Ruling?</p>	<p>It is acknowledged that there will be circumstances where horse racing can be a stand-alone business and this has been confirmed in judicial cases. Further, paragraph 28 of the Ruling no longer states that it would be a rare case indeed where the racing of horses as a stand-alone activity would amount to the carrying on of a business.</p> <p>Rather, paragraph 27 of the Ruling emphasises that it will depend upon the facts and circumstances of each case as to whether the stand-alone horse racing activities of a taxpayer constitute a business. The factors referred to in this comment may be relevant in a particular case.</p> <p>However, consideration is required as to whether either of the significant non-business features in paragraph 28 of the Ruling are present. Further, paragraph 29 of the Ruling requires consideration as to whether a taxpayer can demonstrate that the taxpayer can overcome those non-business features in paragraph 28 of the Ruling.</p> <p>As stated in the Ruling, decisions of the Board of Review, the Tribunal and Courts demonstrate the difficulties a taxpayer will have in establishing that they conduct horse racing as a stand-alone business. As such, an example will not be provided due to the difficulties in identifying clear examples of general application that addresses the matters in paragraphs 28 and 29 of the Ruling.</p>
<p>16</p>	<p>Query as to whether the same entity can have separate 'hobby' and 'business' horses? That is, once a breeding business is accepted, must all the racing stock held by the taxpayer be 'integrated' to form part of the breeding business?</p>	<p>The Ruling states that, for horse racing to be considered an integral part of another business, the racing activities must be inherently connected to the other business. Where the racing of horses is an integral part of a horse breeding business, the horses being raced will be a part of that business and also trading stock of that business.</p> <p>Example 7 of the Ruling addresses circumstances where an entity holds horses as part of a business and also holds a horse separate to that business.</p>

17	<p>Query that the draft Ruling talks about racing as being a hobby but when a hobby is an integral part of a horse training and/or horse breeding business, then the expenses of this hobby would be deductible. If a hobby integral, then surely the hobby has become a business. Does this 'integral' principle apply in all cases – e.g. a motor mechanic in business also conducts drag racing?</p>	<p>Paragraph 27 of the Ruling emphasises that it will depend upon the facts and circumstances of each case as to whether the stand-alone horse racing activities of a taxpayer constitute a business.</p> <p>However, consideration is required as to whether either of the significant non-business features referred to in paragraph 28 of the Ruling were present. Further, paragraph 29 of the Ruling requires consideration as to whether a taxpayer can demonstrate that the taxpayer can overcome those non-business features.</p> <p>However, when racing activities are an integral part of a horse breeding or training business then the racing activities would constitute activities in the carrying on of the breeding or training business. For horse racing to be considered an integral part of another business, the racing activities must be inherently connected to the other business. Activities that are integral to a business will not be a hobby. Similarly an activity that is a hobby will not be integral to the carrying on of a business.</p> <p>Paragraph 33 of the Ruling confirms that it is a question of fact whether there is a business and whether the relevant activities are an integral part of it (as opposed to a separate activity).</p>
18	<p>Query as to when does a horse breeding business commence in the circumstance when an entity purchases younger horses to commence a future breeding business but races them until they reach a suitable breeding age.</p>	<p>Determining if a business has commenced will be a question of fact in each case including in the circumstances referred to.</p>
19	<p>Paragraph 43 of the draft Ruling provides that the gross proceeds from training a horse will not be</p>	<p>The relevant paragraphs of the Ruling now state:</p>

	<p>assessable under section 6-5. It is queried as to whether this principle always apply, for example, if an entity was not in business and gives an address to a horticultural group for \$250, is it assessable income?</p>	<p>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.</p> <p>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.</p> <p>Whether an amount is received in the pursuit of a hobby or a pastime or received in the course of income producing activities, such as carrying on a business, will depend upon the facts in each case.</p>
20	<p>Query as to the consequences of a disposal of an interest in a horse, where that interest is part of a breeding business. In addition, whether the interest in that horse can be notionally disposed of under section 70-100?</p>	<p>Paragraph 42 of the Ruling adopts the view that where horses are co-owned and are used in a horse breeding business, the interest in the horse that is held by the entity carrying on the horse breeding business will come within the definition of trading stock.</p> <p>The issue as to the disposal or notional disposal of the interest in a horse is currently being considered by the Tax Office.</p>
21	<p>Suggested that, in paragraph 65 of the draft Ruling, there be a brief explanation given for CGT event J2.</p>	<p>Paragraph 68 of the Ruling has been inserted to give a brief explanation of CGT event J2.</p>
22	<p>Suggested that the references, in paragraph 65 of the draft Ruling, to Subdivisions 40-F or 40-G be referred to respectively to primary production depreciating assets and landcare operations or electricity connections or telephone lines.</p>	<p>Paragraph 67 of the Ruling has been amended to insert footnotes that briefly explain Subdivisions 40-F and 40-G.</p>
23	<p>Suggested that, in paragraph 103 of the draft Ruling, the reference to Division 35 be noted as applying to non-commercial business activities.</p>	<p>Paragraph 109 of the Ruling has been amended to insert a footnote that briefly explains non-commercial business activities.</p>

24	<p>The Tax Office position in paragraph 122 of the draft Ruling means that a foal bred by a breeder should not be entitled to be written down for tax purposes. It is submitted that the contract for the foal is the stallion service agreement. Therefore, it is suggested that paragraph 122 of the draft Ruling should be:</p> <ul style="list-style-type: none"> <li>• removed from the final ruling; or</li> <li>• amended to make it clear that natural increase can be valued under section 70-60, as the stallion service agreement is the contract for which the foal is acquired.</li> </ul>	<p>Section 70-55 will apply to the foal and not section 70-60.</p> <p>Section 70-55 determines the cost of natural increase – subsection 70-55(2) provides that it is the greater of the amount provided under subsection 70-55(1) (cost or amount prescribed) or the amount of any service fee.</p> <p>It is noted that a requirement of section 70-60 is that the horse must be acquired under a contract and be of at least three years of age.</p> <p>The stallion service agreement is a contract in respect of the servicing only and results in the acquisition of a horse by natural increase.</p>
25	<p>Stated that paragraphs 130 and 131 of the draft Ruling appear to assume that the taxpayer cannot take advantage of the 'Small Business Entity' prepayment rules found in Division 328..</p>	<p>The relevant paragraphs of the Ruling (paragraphs 139 and 140) have been amended to include a reference to the prepayments rules for 'small business entities'.</p>
26	<p>Suggested that Example 1a in paragraphs 145 to 152 of the draft Ruling include advice that an asset which has not been used to produce assessable income is still a depreciating asset. This is because most non-practitioners generally believe it is not a depreciating asset.</p>	<p>The relevant paragraph of the Ruling (paragraph 155) in Example 2 of the Ruling has been amended to provide this clarification.</p> <p>Note: Example 1a in the draft Ruling is now Example 2 in the Ruling.</p>

27	<p>Query whether the ruling can clarify the designation of various horses for CGT purposes:</p> <ul style="list-style-type: none"> <li>• a broodmare held for 'hobby' purposes; and</li> <li>• stallion shares.</li> </ul>	<p>In respect of a broodmare held for hobby purposes, Table 1 in paragraph 18 of the Ruling states that a horse that is not used in a business will be both the entity's CGT asset and depreciating asset.</p> <p>The current Tax Office view on stallion syndicate arrangements can be found in Taxation Ruling TR 93/26.</p> <p>However, this issue is currently being considered with a view to providing further guidance, which may include guidance by way of taxation determination or a public ruling.</p>
28	<p>Suggested that the Ruling contain a one to two page checklist so that an entity can determine whether they are carrying on a business.</p>	<p>Whether an entity is carrying on a business will be a question of fact in each case. The Ruling identifies relevant indicators and specific industry factors (horse breeding) to provide guidance in making such a determination.</p> <p>A checklist will not be provided as a decision can only be made after examining the relevant activities of an entity as a whole taking into account individual facts and circumstances.</p>

29	<p>Other breeding issues that require clarification:</p> <ul style="list-style-type: none"> <li>• only section 70-45 tax values referred to under NCL \$100,000 'other assets test'. Section 70-60 'write down' stock ignored for the purpose of calculating the \$100,000 and this is very unfair and anomalous, especially as the tax value is only considered for the purposes of this provision; and</li> <li>• 'cost' of natural increase when no service fee paid has always been considered as \$20, the minimum value for horses per the regulations. It was suggested that the ATO was considering whether the 'market value' should be used in such circumstances.</li> </ul>	<p>The use of tax values in the 'other assets test' is prescribed in the law. The Ruling is not able to address issues that require changes to the law.</p> <p>In respect of the cost of natural increase, section 70-55 does not provide for the market value to be used to work out the cost. Subsection 70-55(2) applies where the service fee has been incurred (whether or not it has been paid). Where the service fee is incurred, the cost to acquire the horse by natural increase will be the greater of the amount worked out under subsection 70-55(1) or that part of the service fee attributable to acquiring that horse. If a service fee has not been incurred then the calculation of the cost under subsection 70-55(1) applies.</p>
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30	<p>The draft ruling should reflect the Block decision by confirming that horse breeders, grape-growers and farmers do not need to make a profit to qualify for tax deductions. The draft ruling targets horse breeders, saying deductions would depend on industry criteria such as the quality and number of horses and whether the mares are being serviced regularly and that the ruling was the ATO trying to dictate the law, without heed to case law or tax principles.</p> <p>The decision in Block takes into account the capital costs of setting up the business, the subsequent restructuring of the business and the results of a series of unforeseeable setbacks, including the accidental injury and death of 13 stallions, mares and yearlings.</p>	<p>The decision in <i>MR &amp; SL Block v. FC of T</i>,<sup>†</sup> does not provide any general principle in addition to the general indicators and specific industry factors listed in the Ruling. Consistent with the approach adopted in the Ruling, the Tribunal reached its decision after an examination of all the activities and individual facts and circumstances of the taxpayer. The Ruling includes a reference to this decision and the discussion in the Ruling confirms that the Tribunal:</p> <ul style="list-style-type: none"> <li>• considered a number of the relevant indicators such as the purpose and prospect of profit and scope and nature of the activities undertaken in reaching its decision;</li> <li>• considered the existence of losses as well as the reason for them; and</li> <li>• implicitly accepted that racing activities were an integral part of the horse breeding business in that case.</li> </ul>
31	Concerns were raised that the examples in the draft Ruling will be removed from the final version.	The Appendices that contain the Explanation and the Examples have been retained in the Ruling, however, this portion will not form part of the binding public ruling.
32	The \$10,000 CGT threshold is now obsolete and requires drastic action to revise and update it. It is considered that many would be unaware of the CGT threshold and its application in their business affairs. The current \$10,000 threshold is obsolete and that this limit requires revision to a more modern current level of say \$50,000 then escalated annually with \$5,000 increments.	This threshold is prescribed by law. The Ruling is not able to address issues that require changes to the law.

<sup>†</sup> [2007] AATA 1897; 2007 ATC 2735.

33	<p>Currently the industry migrates horses from rural areas through to metropolitan owners and trainers. They are often sold in this progression. The process of buying and selling is an important feature. Given horses in the development phase, their owners should have the capacity to offset expenditure against the sales price in determining a profit for CGT application. To enable this to occur the carry forward of expenditure for a specific period should be considered, say for three to five years. In this manner, matching in an equitable sense can occur for all parties. The establishment of criteria will outline and define this transactional basis. Alternatively, profits derived from such transactions could be deemed exempt as occurs internationally.</p>	<p>Paragraph 2 of the Ruling states that this document is not an attempt to provide comprehensive examination of every income tax issue that may potentially arise, but will highlight the key income tax issues that arise.</p> <p>The Ruling is not able to address issues that require changes to the law.</p>
34	<p>The review by the Australian Taxation Office should also extend its consideration of industry operations between Australia and New Zealand given the significance and commonality of both nations and industry participants. Industry participants should have common application of the incidence of taxation in its varied forms between both countries given the integrated nature of the breeding and racing environments.</p>	<p>Issues with respect to aligning the relevant legislation between Australia and New Zealand are a matter for the Government.</p> <p>The Ruling is not able to address issues that require changes to the law.</p>