NEW LEGISLATION BENEFITS EQUINE INDUSTRY

INTRODUCTION

Members of the equine industry will benefit from revisions to the Federal tax code via the Economic Stimulus Act of February and the recently passed Farm Bill. These two provisions will affect buyers' decisions in 2008 and planning for tax years 2009 and beyond.

To provide an immediate boost to the economy, the benefits of the Economic Stimulus Act extend only to horses and other qualifying property purchased and placed in service in 2008. Buyers must take action this year to realize additional tax savings through a temporary increase in the expensing allowance and a re-introduction of bonus depreciation. A full description of these benefits, including examples and other important details, is below.

The new accelerated depreciation schedule for racehorses included in the Farm Bill begins with purchases in 2009. This allows buyers time to prepare for upcoming tax years. A chart that compares the new and old depreciation schedules and examples follow the Economic Stimulus Act section (see page 6).

Relief from livestock losses also is included in the Farm Bill and information on this provision is located on page 7. This benefit to horse breeders took effect when the bill became law in May.

ACTION REQUIRED DURING 2008

Expense Allowance

AMOUNT OF THE ALLOWANCE - A horse business can write-off (expense) up to $250,000 of the cost of a horse or horses purchased and placed in service in 2008. Farm equipment and other depreciable property are also eligible for the deduction, subject to an overall limitation in 2008 of $250,000. Buildings are not eligible. Automobiles and light duty trucks are subject to special rules. The balance of the cost of property after taking the expense deduction is depreciated using regular depreciation and may also be eligible for bonus first year depreciation.

REDUCTION FOR EXCESS INVESTMENT - The expensing amount is reduced by one dollar for each dollar of the cost of eligible property purchased during the year over $800,000. For example, a person who purchases horses, equipment, and other eligible depreciable business property in 2008 at a total cost of $900,000 would only be able to expense $150,000 ($250,000 less $100,000 ($900,000 - $800,000)).

FULL AMOUNT OF EXPENSE DEDUCTION TAKEN REGARDLESS OF WHEN DURING THE YEAR PURCHASE IS MADE - An expense deduction of up to $250,000 is allowed even if the horse or other business property that is expensed, in whole or part, is purchased and placed in service on the last day of 2008. The deduction is not prorated based on the time the property was in service during the year.

APPLIES TO NEW OR USED PROPERTY - The expense allowance can be taken on purchases of new or used property. Thus, the purchase of a racehorse broodmare qualifies for the write-off even if it had been raced or bred by someone else before the purchase.

MUST BE USED AGAINST BUSINESS INCOME - The expensing allowance can only be used to reduce taxable income derived from the horse business or any other business from which the taxpayer has income. The income need not come from the horse business that generated the expense allowance if the horse business had a loss in 2008. Furthermore, wages, salaries, and other compensation of the taxpayer is treated by the IRS as income derived from a business. Any credit that cannot be used can be carried forward to other years when business income is available.

REQUIRES AN ELECTION - To take the expensing allowance, the taxpayer makes an election on his or her tax return by claiming the total as a separate item on the return and the portion of that amount allocable to each specific item of property.

THE TAXPAYER CAN PICK AND CHOOSE THE HORSES OR OTHER PROPERTY THAT IS EXPENSED - The choice of which property is expensed is done by the taxpayer. For example,

assume in 2008 the taxpayer purchases three horses, one cost $50,000, one cost $100,000, and one cost $250,000. No other purchases of eligible business property were made. The taxpayer can spread the deduction around to all three of the horses, to two of them, or take the entire expense deduction on the horse that cost $250,000. Generally, the taxpayer would want to use the allowance for the property that has the longest depreciation write-off period.

MARRIED TAYPAYERS TREATED AS ONE - A married couple only gets to deduct a total of $250,000, even if they file separate tax returns. The same rule applies to the $800,000 investment limitation.

PARTNERSHIPS - Any expense allowance passed through from the taxpayer's interest in a partnership must be included under the overall $250,000 limitation. However, the cost of the property is not attributed to the partner in determining the amount in excess of the $800,000 investment limitation.

THE EXPENSE DEDUCTION GOES BACK DOWN IN 2009 - The expense allowance will go back down to $128,000 (plus an inflation adjustment) in 2009, instead of $250,000, and the dollar for dollar reduction in the deduction for excess purchases will start at $510,000 (plus an inflation adjustment), instead of $800,000.

Bonus First Year Depreciation

FIFTY PERCENT BONUS DEPRECATION - The Economic Stimulus Act of 2008 allows an additional first year depreciation deduction equal to 50% of the cost of horses and other eligible depreciable property purchased and placed in service in 2008.

FULL FIFTY PERCENT ALLOWED REGARDLESS OF WHEN DURING 2008 THE HORSE IS PLACED IN SERVICE - Whether the horse or other eligible property is purchased and placed in service in January or December, or any month in between, the bonus deduction is still 50% of the cost. This is better than regular depreciation since normally the taxpayer only gets six months of depreciation the first year the horse is placed in service.

ELIGIBLE PROPERTY - To be eligible: (1) the horse or other property must be depreciable property with no more than a 20-year depreciation life; and (2) the horse or other property cannot have been used for any purpose by anyone prior to the purchase. Automobiles and light duty trucks are subject to special rules. The original use of the property must commence with the taxpayer after December 31, 2007. Horses that are raced outside the U.S. for more than 50% of the time during the year are not eligible. In the case of a horse purchased for breeding,

which has been raced by someone other than the purchasers, the IRS regulation gives the following example with respect to the prior bonus depreciation law:

On April 1, 2000, E acquires a horse to be used in E's thoroughbred racing business. On October 1, 2003, F buys the horse from E and will use the horse in F's horse breeding business. The use of the horse by E in its racing business prevents the original use of the horse commencing with F. Thus, F's purchase price of the horse does not qualify for the additional first year depreciation deduction.

PURCHASE OF A TWO-YEAR-OLD IN TRAINING - Assume that the taxpayer purchases a two-year old in training which has not been raced by anyone prior to the purchase, and which has been trained by the seller. Would this two-year-old qualify as property that was not used for any purpose by anyone prior to the purchase? Based on the industry practice of treating "training" as the time when the horse is placed in service, the IRS could take the position that the first use of the horse commenced with the seller when training began.

Would it make any difference if the young horse was a homebred and, therefore, the seller did not depreciate the horse prior to sale? Technically, this probably does not make any difference if the horse was trained.

In either case, in order for the IRS to deny the bonus depreciation deduction, the IRS would have to take the position that a racehorse is "placed in service" when training starts. While it has been an industry practice for years, the IRS has never officially said that a racehorse is "placed in service" when it begins training.

BONUS DEPRECIATION AND EXPENSING CAN BE USED TOGETHER - A horse or other property is eligible for bonus depreciation even if a portion of the horse, or other property, had been expensed. For example, assume a yearling racehorse is purchased in 2008 for $550,000 and the purchaser makes no other purchases of horses or other business property in 2008. The purchaser on his or her 2008 tax return can expense $250,000, deduct bonus depreciation of $150,000 (50% of $550,000-$250,000), and take regular depreciation of $16,072 on the remaining $150,000 balance. This brings the total deduction for the year to $416,072, over 75% of the cost of the yearling.

BONUS DEPRECIATION APPLIES UNLESS TAXPAYER ELECTS NOT TO USE IT - Bonus Depreciation applies unless the taxpayer elects not to use bonus depreciation. Thus, under the way the depreciation rules work, a taxpayer who does not make an election to opt out of bonus depreciation will nevertheless have basis in such property reduced by the amount of the depreciation that could have been taken. As such, the taxpayer could lose depreciation on 50%

of the cost of eligible horses, equipment, and other eligible property placed in service in 2008. This also complicates the decision about whether to take bonus depreciation on the purchase of a horse that has been trained by the seller, but not raced. Obviously, it is important to elect out if the owner is not going to use bonus depreciation.

FASTER DEPRECIATION BEGINS WITH PURCHASES STARTING JANUARY 1, 2009

Under the tax laws in effect through the end of 2008, racehorses are depreciated over either three or seven years, depending on their age when "placed in service." A horse is generally deemed to be placed in service when it begins training. Racehorses over the age of 24 months (from date of foaling) when placed into service are depreciated over three years; otherwise, they are depreciated over seven years. In a given crop of horses that make it to the track, about half will start as two-year-olds and the rest will start as three-year-olds. Most racehorses (except geldings) are off the track by age five, making a seven-year depreciation schedule anachronistic.

Legislation contained in the 2008 Farm Bill allows an owner to recover his/her costs over the period of time that the horse is likely to race. The new "three-year" depreciation schedule, which applies to yearlings and other racehorses 24 months old or younger, starts next year and sunsets on the last day of 2013 unless Congress extends it beyond that date. While it is a three-year depreciation period, the deductions are spread over four tax years since only six months of depreciation are allowed in the first year. The following chart illustrates the new and prior rates of depreciation.

*New 3-Year Schedule (2009-2013) for Racehorses 2YO and under**	*Old 7-Year Schedule for Racehorses 2YO and under*
3-Year (4 tax years)	7-Year (8 tax years)
Yr / % of Original Cost	***Yr / % of Original Cost***
1. 25.0%	1. 10.72%
2. 37.5%	2. 19.13%
3. 25.0%	3. 15.03%
4. 12.5%	4. 12.25%
100%	5. 12.25%
	6. 12.25%
	7. 12.25%
	8. 6.12%
	100%

** These schedules assume the half-year convention applies, meaning all horses placed in service during the year are deemed to be placed in service on July 1. The seven-year schedule applies until January 1, 2009 to racehorses 24 months old or younger when placed in service. Racehorses over 24 months when placed in service are now and will continue to come under the 3-year schedule.*

Note that under the 3-year schedule, 62.5% of a racehorse can be written off by the end of the 2-year-old year, as compared to only 29.85% under the old schedule for the horses. Also, note that horses also may be eligible for expensing the first year, which would mean an even higher percentage is written off by the time the horse reaches three years old. Expensing is taken before the depreciation deductions are taken.

The schedules below compare the depreciation deductions for a racehorse yearling purchased in 2009 for $50,000 using the new faster schedule and the depreciation deductions using the old seven-year schedule required for yearlings purchased prior to 2009.

New 3-Year Schedule	*Old 7-Year Schedule*
Yr / Depreciation	***Yr / Depreciation***
1. $12,500	1. $ 5,360
2. $18,750	2. $ 9,565
3. $12,200	3. $ 7,515
4 $ 6,250	4. $ 6,125
$ 50,000	5. $ 6,125
	6. $ 6,125
	7. $ 6,125
	8. $ 3,060
	$50,000

Livestock Losses

The Farm Bill also contains other provisions to assist members of the equine industry. These are currently in effect.

Horse breeders will be allowed two forms of federal emergency disaster relief: emergency loan eligibility and fund access. Horse breeders previously have not been eligible for emergency loans following disasters such as hurricanes, floods, ice and drought. Under the new Farm Bill, "equine ranchers and farmers" are included in a group of other livestock producers who have been eligible to apply for such loans in the past. Equine ranchers and farmers who suffer losses in areas that are declared disaster areas by the United States Department of Agriculture (USDA) also now may be able to receive relief funds under a new disaster assistance program. The program is designed to expedite funds to eligible producers who experience a disaster.

Available equine tax publications

Horse Owners and Breeders Tax Handbook ($85 plus $4.50 S/H)
A 1,000-page guide for horse owners and breeders explains the Internal Revenue Code as it pertains to the U.S. Horse Industry. No one commercially involved with the horse industry can afford to be without this handbook.

Tax Tips for Horse Owners ($10)
An 18-page booklet that includes, in outline form, the major tax issues affecting those involved with horses as a business.

Both publications by Thomas A. (Tad) Davis, Esq.

Order by visiting www.horsecouncil.com

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