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Question We've Been Asked – Income Tax and Goods and Services Tax – Treatment of Bloodstock Breeding Partnership – PUB00290

Introduction

1. The New Zealand Law Society welcomes the opportunity to comment on the Question We've Been Asked *Income Tax and Goods and Services Tax – Treatment of Bloodstock Breeding Partnership* (the QWBA).

2. The QWBA outlines the Commissioner's view on whether a horse breeding syndicate or partnership, whose activities involve the purchase of a horse for breeding which is raced before being used in a breeding capacity, is carrying on a bloodstock breeding business and, secondly, if it is carrying on a taxable activity for GST purposes.

3. The Law Society has concerns about the income tax analysis and outcomes adopted by the Commissioner in the QWBA and makes the following comments.

Comments

4. The Law Society disagrees with the Commissioner's analysis of *Drummond v CIR* (2013) 26 NZTC 21,023 and considers that case cannot reasonably be viewed as establishing a general rule that is applicable to all new horse breeding syndicates/partnerships. The Law Society regards *Drummond* as a case decided on its facts in which Brewer J found the partnership/syndicate to be in the business of horse racing without a clear intention at the outset to breed the horse. So, contrary to the position taken in the QWBA, the Law Society considers that *Drummond* does not necessarily apply to a situation where a syndicate / partnership (which formed from the purchase of a filly or colt) has a clear intention to breed the horse for profit and follows a specific business plan to bring that business to fruition (including racing to enhance future breeding prospects).

5. It is difficult to reconcile the wording of section EC 39 with the Commissioner's conclusion that section EC 39 requires a pre-existing bloodstock breeding business before it can be applied. This position is inconsistent with the heading of section EC 39(1)(c), "**First Income Year in Breeding Business**," which suggests that the section applies in the year that a breeding business commenced. (This language is also repeated in the operative words of section EC 39). Accordingly, the business should not be viewed as being required before the first breeding

horse is purchased; it is sufficient if the business has commenced by the end of the income year in question.

6. The judgment in *Drummond* was that no breeding business had commenced by the income year in which the deduction was sought and in fact on the facts in that case never commenced.

7. We note that IRD's interpretation creates a material distinction between first time investors and those carrying on another bloodstock breeding business outside of the partnership, even when both types of investors have invested in the same partnership. The Law Society has not found any support in the legislative history for the conclusion that the first time investor is intended to have an adverse treatment relative to investors who have another investment at the breeding stage.

8. Finally, while the views of the Commissioner set out in the QWBA focus on breeding syndicates/partnerships, The Law Society is concerned that some of the analysis adopted by the Commissioner in considering when a business commences could have wider application in relation to other activities.

9. Through the QWBA's deliberate distinction between the bloodstock industry and orchard and forestry cases, the QWBA appears to make the proposition that ventures which encompass some element of speculation will be prohibited from being a business until the venture starts producing. In particular, where a start-up business purchases key assets (such as in the QWBA, the horse) and commences activities consistent with its plan, it appears that IRD may be suggesting that those activities are generally in advance of commencing a business. It is not clear what IRD's position is in relation to, for example, start-up IT businesses that are developing software. Presumably the intent is not to treat horse breeding businesses less favourably than other businesses. If this is correct, the QWBA may have implications for other businesses. The Law Society recommends that the QWBA be reconsidered before it is finalised.

Conclusion

10. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours sincerely

Kathryn Beck
President