WRITERS UP

Editor's note: Since passage of important federal legislation in the past 18 months, Keeneland and the NTRA have been working to educate horse owners about the new and improved benefits of racehorse ownership. Keeneland and the NTRA have asked Thomas A. "Tad" Davis, Esq., tax counsel to the NTRA and the American Horse Council, to provide the following benefits analysis for prospective buyers.

TAX WRITE-OFFS MAKE 2009 A GREAT YEAR TO BUY A YEARLING

by Tad Davis

Thanks to the 2009 Economic Stimulus Bill and the new depreciation schedule for race horses that became effective this year, 2009 is a great year to buy a Thoroughbred. The depreciation and expensing allowances have never been better. Buyers may be able to write off a substantial portion of the cost of the horse in the year of purchase--if not the entire cost of the purchase.

The more generous write-off allowances for Thoroughbreds and other race horses purchased this year result from three changes to the tax law, all of which come into play in 2009. The Economic Stimulus Bill continued bonus depreciation for 2009, which allows a deduction of 50 percent of the cost of a yearling. In addition, it continued the higher expense deduction into 2009, which allows a taxpayer to deduct up to $250,000 of the cost of a horse in the year it is purchased. As is usually the case in the tax law, there are some limitations and requirements that apply to both provisions.

The third change, contained in the Farm Bill, allows all racehorses to be depreciated over three years (four tax years). Prior to 2009, yearlings had to be depreciated over seven years (eight tax years). As the table to the right shows, the first year deduction is 2.5 times better than in prior years and could be three times better if the purchaser is only engaged in racing, and not racing and breeding, or just breeding. (A wrinkle in the tax law that is best explained by one's tax advisor.) The new rules let the purchaser write off 62.5% of the cost in the first two years or almost 75% of the cost if the purchaser is engaged only in racing.

New three-year schedule (2009-2013) for racehorses 2yo and under

Year	% of Original Cost
1	25
2	37.5
3	25
4	12.5
	100%

Old seven-year schedule for racehorses 2yo and under

Year	% of Original Cost
1	10.72
2	19.13
3	15.03
4	12.25
5	12.25
6	12.25
7	12.25
8	6.12
	100%

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Tax Write-Off cont.

Applying all of these write-off benefits to the purchase of a yearling this year can produce rather dramatic results. For example, if a buyer purchases a yearling this year for $250,000 and buys no other horse or other business property this year, he can expense (i.e., write off) the entire cost.

Even if he buys a second yearling for $500,000, he can still write off the entire $250,000 cost of the yearling he bought first and he can take a depreciation deduction of $312,500 for the second purchase, for a total write-off of $562,500 in 2009. That works out to 75% of the total $750,000 cost of the two yearlings. If the buyer is <u>only</u> engaged in racing, and not racing and breeding, he can use a slightly better depreciation rate that would result in $20,000 more depreciation in 2009.

The expense deduction is reduced dollar-for-dollar as purchases of horses and any other property used in your business exceed $800,000 during the year. In practical terms, the expense deduction phases out dollar-for-dollar, reaching zero once purchases during the year hit $1,050,000.

In the above example, had the buyer paid $800,000 for the second yearling, he would not be entitled to the $250,000 expense allowance, since total purchases would have been $1,050,000. He could still take bonus depreciation on the total cost of both yearlings (50% X $1,050, 000 = $525,000) and regular depreciation on the balance using the new rules (25% X the balance of $525,000 = $131,250). The total depreciation deduction would be $656,250, or 62.5% of the cost of the two yearlings. If the buyer is <u>only</u> engaged in the racing business, the total depreciation deduction would be about $44,000 more, bringing the deduction to about $700,000, some 67% of the cost.

It is easy to see from the examples why the current tax benefits are good for the upcoming yearling sales this year. Next year's tax benefits will not be as good unless Congress extends the current package. Bonus depreciation expires at the end of this year and the $250,000 expense allowance goes down to $125,000 next year, with the dollar-for-dollar phase out starting at $500,000 instead of $800,000.

Assuming the economy continues to improve, it will probably be a long time before a buyer gets the generous first-year write-offs that are available for purchases this year. Tax incentives such as these aren't likely to last as the country recovers from recession and buyers should plan--and act--accordingly.

Thomas A. "Tad" Davis, Esq., is a partner in the law firm of Davis & Harman LLP. He specializes in legislative and administrative law issues, particularly in the areas of tax, financial markets and agricultural policy. He is the author of Horse Owners and Breeders Tax Handbook, which is recognized as the leading authority on tax issues related to the equine industry.