Legislative Issues

Economic Stimulus Bill

Introduction

Congress wrestled all fall with a tax package intended to stimulate the economy in the wake of the terrorist attacks on the U.S. on September 11. While the Republican-controlled House passed its version of the stimulus package several times, it hit a roadblock in the Democrat-controlled Senate. Finally, on March 8, Congress passed a scaled-back version of the ambitious tax bill originally proposed by both the Republicans and Democrats. The final package was crafted to include the necessary level of tax cuts, small business tax breaks and unemployment benefits needed for passage in both the House and Senate.

Although the horse industry supported the broader Republican version of the stimulus bill passed last December by the House, the final package signed into law by President Bush on March 9, 2002 includes new depreciation provisions that will benefit the horse industry.

Congressional Action

The “Economic Stimulus” package includes new depreciation provisions that are very favorable to the horse industry. The favorable provisions apply to all horses, regardless of breed or use, provided they are used in a trade or business. Importantly, the new benefits apply retroactively to purchases after September 11, 2001. It could therefore have an affect on 2001 tax returns.

<u>Bonus Depreciation</u>. The new depreciation rules allow a 30% “bonus depreciation” in the year of purchase, in addition to regular depreciation on the balance. To qualify for the new bonus depreciation, the horse or other asset must be purchased during the three-year period from September 11, 2001 to September 11, 2004 and be placed in service during the period from September 11, 2001 to January 1, 2005. In addition, the “original use” of the property “must commence with the taxpayer.” According to the official explanation of the new law, the term “original use” means the first use to which the property is put, whether or not such use corresponds to the use of such propery by the purchaser.

This latter “original use” requirement was included because the changes are intended to stimulate investment and the economy. Congress apparently felt that only the individual who invests in the asset for its first use should be entitled to the bonus depreciation. Thus, the additional depreciation benefits are limited to the individual who purchases and places a race or show horse in service first. If a person purchases a horse that has been raced or shown by another, that purchaser will not be entitled to the bonus write-off.

While this “original use” restriction excludes horses purchased after they have been raced, shown or bred by someone other than the purchaser, it is unclear whether a horse which has been raced or shown, but has never been bred, would qualify for the bonus depreciation if purchased for breeding. Since the horse has never been used for breeding, it can be said that the "original use" of the horse as a breeding animal commences with the purchaser. Based on the previously cited official explanation of the new law, the horse would probably not be eligible for bonus depreciation because the "original use" did not commence with the purchaser. On the other hand, it could be argued that horses are a different type of property than the official explanation and tax credit regulations contemplated. They contemplated machinery or equipment which is used for a single purpose as compared to horses that have a variety of uses, each of which could be said to be a new use. This argument is even stronger if the horse has never been depreciated as business property when it is purchased.

A horse which will be raced more than 50% of the year outside the U.S. does not qualify for the new bonus depreciation. On the other hand, it appears that a horse which is purchased abroad does qualify if raced or otherwise used most of the time in the U.S.

The new rules will allow 37.5% of the cost of a yearling purchased after September 11, 2001 to be written off in the first year, more than three times the amount allowed under the old depreciation schedules. Over 50% of the cost would be written off by the end of the second year, almost twice what was allowed previously. Show horses or breeding stock under twelve would be eligible for the same write-offs, provided the purchaser is the "original user." With respect to race horses over two and other horses over twelve, which have not been raced or shown before, 47.5% of the cost could be depreciated in the first year and 74% would be written off after the second year.

The new provisions also benefit purchasers of other assets used in the horse business. Purchases of equipment and any other business property which has a depreciable life of twenty years or less will also be eligible for the 30% write-off in the year the property is acquired and placed into service. This would include virtually all equipment used by farms, training facilities, racetracks and horse shows. Buildings and their components would not qualify.

<u>Mid-Quarter Convention</u>. All of the depreciation figures described above would be slightly lower if more than 40% of the cost of all purchases of depreciable property made during the year were made in the last quarter of the year.

<u>Expensing</u>. Unlike earlier versions of the stimulus bill, the law finally enacted did not change the current Section 179 expensing deduction for horses or any other property, except property placed into service in the Liberty Zone of New York City. However, the current expensing deduction, which allows up to $24,000 of first year write-off, may also be available. If so, the deductions are even greater in the year a horse or other asset is purchased and placed into service.

AHC Position

The horse industry supported the tax stimulus package.