GREATER TAX INCENTIVES FOR YOUR 2011 PURCHASES

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The following tax benefit update was provided by Thomas A. (Tad) Davis, Esq., tax counsel for the NTRA and the American Horse Council. We hope you find this information valuable as you plan your purchases for 2011. Please contact me with questions: Joe Bacigalupo (800) 792-6872, ext. 677 or joeb@ntra.com.

BONUS DEPRECIATION & HIGH EXPENSE ALLOWANCE

On December 17, 2010, the President signed into law the high profile tax bill that extended the current income tax rates and many other tax benefits that were expiring at the end of 2010. Included in the new law, in addition to lower rates, were several provisions that can significantly lower taxes for thoroughbred owners and breeders. Certainly two of the most important benefits are the continuation of more generous bonus depreciation and a higher expense allowance through 2012.

Bonus Depreciation was increased to 100% for eligible horses or farm equipment placed in service after September 8, 2010 and before January 1, 2012. In other words, the entire cost of eligible horses or farm equipment purchased and place in service during that period can be written off. For example, two yearlings purchased and placed in service in 2011 at a total cost of $1 million can be entirely written off that year. The rate goes down to 50% for eligible horses placed in service during 2012. As has been true in the past, to be eligible for bonus depreciation the original use of the eligible property must commence with the purchaser. Any prior use, personal or business, disqualifies the property.

The Expense Allowance currently in effect allows the purchaser to write off up to $500,000 of the cost of horses or farm equipment purchased and placed in service in 2010 and 2011 if the total of all purchases of depreciable property during the year do not exceed $2 million. If purchases exceed $2 million, the expense allowance goes down one dollar for every dollar purchases exceed $2 million. Unlike bonus depreciation, the expense allowance applies to all horses or farm equipment regardless of whether they have been previously used for some purpose by someone else. The expense allowance was scheduled to go down to $25,000 in 2012 and thereafter. The new law changes the expense allowance to $125,000 in 2012, with an investment phase-out that starts once purchases exceed $500,000.

The new law also keeps the top tax rate on capital gains and dividends at 15% through 2012. Otherwise, the top rate on capital gains would have gone to 20% and the top rate on dividends to 35%.

Estate tax rates in 2011 and 2012 will be a maximum of 35%, with an exemption of $5 million per person and $10 million per couple. Estates of people who died in 2010 will have an election to choose no estate tax and modified carryover basis or the 2011 rates and exemptions.

The limits on contributions of Conservation Easements and the carryforward period for contributions of appreciated real property in effect in 2009 were extended in the new law through 2011.

SUMMARY OF TAX INCENTIVES

INCREASED BONUS DEPRECIATION

- 100% bonus depreciation in effect
- Applies to horses, farm equipment and most other depreciable property
- Property must be purchased and placed in service after 9/8/2010 and through 12/31/2011
- Full 100% bonus depreciation allowed regardless of when during that time eligible property is purchased and placed in service
- Property must be new – original use of property must commence with taxpayer
- Rate reverts to 50% bonus depreciation for 2012

HIGH EXPENSE ALLOWANCE

- Expense allowance for horses, farm equipment and most other depreciable property is $500,000
- Property must be placed in service in year purchased
- Applies to new or used property
- Expense allowance is reduced one dollar for each dollar of eligible property purchased that exceeds $2 million
- Can be used to reduce taxable income derived from business of taxpayer
- Effective through 2011
- Expense allowance drops to $125,000 for 2012

REMINDER – FASTER DEPRECIATION FOR RACEHORSES

THE CURRENT BENEFIT OF 100% BONUS DEPRECIATION SUPERCEDES THE SCHEDULE BELOW. THIS 100% BONUS DEPRECIATION BENEFIT EXPIRES AT THE END OF 2011.

Under earlier tax laws, racehorses were 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 were 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, started on January 1, 2009 and sunsets on the last day of 2013 unless Congress extends it beyond that date. This means that during the 2009-2013 period, all racehorses are depreciated using the three-year schedule. 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 24 mos. and under

3-Year (4 tax years)

Yr	Depreciation	
1.	$25,000	(25.0%)
2.	$37,500	(37.5%)
3.	$25,000	(25.0%)
4.	$12,500	(12.5%)
	$100,000	***TOTAL***

Old 7-Year Schedule for Racehorses 24 mos. and under

7-Year (8 tax years)

Yr	% of Original Cost	
1.	$10,720	(10.72%)
2.	$19,130	(19.13%)
3.	$15,030	(15.03%)
4.	$12,250	(12.25%)
5.	$12,250	(12.25%)
6.	$12,250	(12.25%)
7.	$12,250	(12.25%)
8.	$6,120	(6.12%)
	$100,000	***TOTAL***

Note that under the 3-year schedule, 62.5% of a young 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 these racehorses. Also, note that these 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.

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