STATE OF CALIFORNIA

BOARD OF EQUALIZATION

110.0003

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
H--- F---, INC.	)	No. SR -- XX-XXXXXX-010
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Susan M. Wengel on March 16, 1992 in ---, California.

Appearing for Petitioner:

Mr. D--- M---
Manager, Horse Division

Mr. J--- T. K---
Corporate Controller

Mr. T--- R. F---
Attorney at Law

Appearing for the
Sales and Use Tax Department:

Mr. Charles Tavookjian
Supervising Tax Auditor

Mr. Bud A. Jones
District Principal Auditor

Protested Item

The protested tax liability for the period July 1, 1986 through December 31, 1989 is measured by:

Item	State, Local and County
C. Ex-tax purchase of two mares from out-of-state vendor, reported measure understated.	$100,000

Contention of Petitioner

When petitioner purchased two mares with unborn foals for $225,000, a deduction of $100,000 should be made for the value of the unborn foals as the foals were purchased for resale.

Summary of Petition

Petitioner is a corporation engaged in operating a large farm. A part of this operation involves the purchasing, breeding, racing and selling of race horses. During an audit by the Sales and Use Tax Department (Department), the audit staff found that petitioner had made ex-tax purchases of two mares, each with an unborn foal. Petitioner acknowledges that tax is due on its out-of-state purchase and in-state use of these mares, however, it contends that $100,000 of the $225,000 purchase price was the value placed on the foals. In support of its position, petitioner asserts that the value of the mare is greatly enhanced by the pregnancy. Records are kept of the selling price of mares with unborn foals. These records are published in a publication by Bill Oppenheim called the Racing Update. The value of the foals for each stallion is recorded as well as the advertised stallion fees. Petitioner has stated that this publication provides a world-wide marketplace analysis for thoroughbred owners. Petitioner's proposed valuation of the unborn foals is based on this publication.

The department takes the position that no deduction is allowable as petitioner purchased a breeding mare for use and that the unborn foal was also purchased for use. The contract of sale did not place a value on the unborn foal and did not provide for a refund if the foal was born dead. Petitioner refutes this finding by citing the case of Launce E. Gamble and Joan L. Gamble v. Commissioner of Internal Revenue (1977) 68 T.C. 800. It is alleged that an allocation for the value of the unborn foal should be allowed because the Tax Court allowed an extra portion of the price paid for the brood mare to become the cost basis allocable to the foal.

Petitioner remitted a payment of $13,909.61 to the Board which represents tax on $125,000, which is the portion of the purchase price petitioner apportioned to the value of the mares.

Analysis and Conclusions

The sole issue is whether petitioner purchased two separate animals when each brood mare was purchased. Petitioner takes the position that the mare was purchased for use, and thus taxable, and that the foal was purchased for resale, and not taxable. We do not agree for several reasons.

First, the facts do not support a finding that petitioner was purchasing two separate animals. The contract did not separately state a value for the foal and did not provide for a refund of any portion of the purchase price if the foal was born dead.

Secondly, the case of McConville v. State Board of Equalization (1978) 85 Cal.App.3d 156, holds that the breeding of mares is a taxable use and not merely a use that relates to the sale of the horse. In reaching this conclusion the court held:

> "The record established without contradiction that mares which have not foaled or are not in foal are of substantially reduced value and difficult to sell; a mare without offspring or not currently in foal is suggestive of a mare with breeding problems, and a showing that the mare is capable of conceiving is necessary to create a purchase interest toward the animal. Our conclusion is unaltered by the fact that plaintiff might separately sell the foals produced by the mares held for sale." (85 Cal.App.3d at 161.)

The McConville court has found that the value of a breeding mare is enhanced if the mare is in foal. Quite clearly, petitioner paid more for the mares because they were in foal. No portion of the selling price, however, stated a specific value for the foal. The contract did not even guarantee a live birth or provide for a refund if the foal was not born alive. We are left with the conclusion that the value of each mare was increased because each animal, by being in foal, had shown that it was capable of conceiving. By creating a purchase interest in each mare, the seller was able to obtain a higher selling price. The entire contract price therefore is subject to use tax with no allocation for the unborn foal.

Petitioner contends that the Board should adopt a position taken by the Internal Revenue Service and make an allocation for the value of the unborn foal. Initially, it is noted that rulings by the Internal Revenue Service are not binding on the Board. However, a reading of the ruling in Launce E. Gamble and Joan L. Gamble v. Commissioner of Internal Revenue (1977) 68 T.C. 800 shows that the court found that the cold was property used in petitioner's business and was not resold in the regular course of business. As a capital asset, petitioner was allowed depreciation and was permitted to set a basis for this depreciation based on the cost of insuring the foal before it was born. We find no basis for using any method of allocation for purposes of developing a purchase price of the mare when the contract already sets the value.

Recommendation

It is recommended that the tax liability be redetermined without adjustment.

August 20, 1992

SUSAN M. WENGEL, STAFF COUNSEL DATE

8-24-92