

CATHERINE E. WILLSON

CANADIAN EQUINE LAW



A GUIDE FOR ANYONE WORKING
WITH HORSES IN CANADA

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DEDICATION

This book is dedicated to the many Canadian horse lovers who work tirelessly in a tough industry for the love of the horse. Happy trails!

INTRODUCTION

1. THE BUSINESS OF HORSES

Many of us ride as a hobby. We pay for our horses with after-tax dollars and we expect little or no return, apart from the sheer joy of the sport. Others are more ambitious. They treat it as a business and fully expect to make a profit on their efforts.

While it is relatively simple to classify people at either end of the spectrum, many horse owners' activities fall into the grey area between a hobby and a business. These people struggle to make a profit in their horse operations and their success is limited. Not only do they find their profit readily taxed by Canada Revenue Agency (the "CRA," the federal government tax authority), but their losses are frequently disallowed by the CRA.

For those wanting to run a horse business, it is extremely important that the operation be managed as a business, using sound business practices. For the CRA, if it doesn't look, walk, and quack like a duck, it's no duck. Sound business practices, which can be found in many simple "how to" business books such as *Starting a Successful Business in Canada Kit* (Self-Counsel Press), include:

- A written business plan.

- A written projection of income and expenses for at least one but preferably two to five years in advance.
- The maintenance of proper books and records.
- A business banking account separate from personal accounts.
- Appropriate investigation and research into the business.
- Appropriate supervision of the business.
- Membership in useful associations and subscriptions to relevant publications.
- Solicitation of professional assistance such as accountants, lawyers, or horse professionals.

There are many advantages to running a horse operation as a business — the deductibility of losses and limited liability being two. It is important to choose the right vehicle within which to commence your business in order to take best advantage of the available benefits. For example, the first few years of a horse business are rarely profitable. At its commencement, it is more advantageous to choose a business structure that allows for the flow-through of losses to you personally as these losses can be offset against other personal income to reduce your overall taxes. Later, when the horse business is more routinely profitable, you may choose to incorporate the business to take advantage of the reduced tax rates inside a corporation and to obtain personal protection from liability.

A horse business can be created using any one of the following business structures:

- Sole proprietorship
- Partnership or limited partnership
- Incorporated company

Your choice of vehicle will be determined by the amount of risk the business carries, tax considerations, the number of participants, and other circumstances unique to that business. It is advisable to speak with an accountant or a lawyer prior to commencing the horse business.

2. SOLE PROPRIETORSHIP

An individual can commence and carry on a business in his or her own name without having to complete any legal documents or other formalities. This is known as a sole proprietorship. The individual, as owner of the business, has the right and the responsibility to make all decisions

concerning the business. If you commence a horse operation for the purpose of making a profit, without a more formal business organization, you are, in effect, operating a sole proprietorship.

The primary advantage to carrying on a sole proprietorship is its ease of commencement and dissolution. You could buy a horse tomorrow with the intention to somehow make money with it, and you are in business. Start-up costs for the business are kept to a minimum. You can even carry on business under a name other than your own name (a business name).

Because a sole proprietorship does not have a separate legal identity, all income, capital gains, or losses are attributed to the owner and taxed in the owner's hands. This is useful for the first few years when your business will usually incur losses which can be offset against other personal income. (**Note:** Loss deductions may be restricted by section 31 of the federal *Income Tax Act*.)

The primary disadvantage of a sole proprietorship is its lack of separate legal identity. The sole proprietor is personally liable for any losses incurred by the business. All of the owner's assets are at risk in the event of a business failure. The sole proprietor is also liable for the actions of any employee of the business carried out in the course of his or her employment. This is a tremendous risk to assume, depending on the nature of the business. With horses, one bad accident could not only put you out of business but cost you everything you own. Appropriate insurance coverage is necessary.

As part of a requirement for annual filings, it is incumbent on the sole proprietor to make accurate records of the business being carried out. Note that it is an offence for any owner of a business that has gone bankrupt to have omitted to keep proper records of the business for the two years preceding bankruptcy.

3. PARTNERSHIP

When two or more people carry on an activity together with a view to making a profit, they have formed a partnership. Each partner has some degree of personal involvement and control. Each partner is entitled to a share of the profits and is liable for a share of any loss. Partnerships are governed by provincial legislation: in Ontario, refer to the *Partnerships Act* and the *Limited Partnerships Act*. Other provinces have similar statutes.

There are two main advantages to using a partnership, the first being its ease of formation and dissolution. It is recommended, but not required,

that the names and addresses of the partners and the name under which the business is carried on be registered with the appropriate government agency. Filing fees are low. Dissolution of the partnership takes place when one partner gives notice of dissolution or, where the partnership has been created for a fixed term, at the end of the fixed term.

The second advantage is its flexible management structure. The relationship between the partners is contractual. The partners can draw up an agreement between themselves dealing with the management of the partnership, distribution of profits, liabilities, and anything else they feel is important. As such, the partnership can be organized to accommodate a variety of business arrangements. Horse syndications (discussed in more detail in section 5.) are a form of partnership.

Income and loss flow through the partnership to the individual partners and are shared between the partners equally or in accordance with their partnership agreement. The income or loss must be included in the partners' personal annual tax filings.

In recent years, many investors have taken advantage of this investment vehicle to flow through losses of the partnership to be applied against income earned by the investor in other areas and ultimately, reduce the amount of taxes the investor is required to pay for that year. Many limited partnerships (the difference between a partnership and a limited partnership explained in a moment) are tax driven.

The partnership suffers from the same disadvantage as the sole proprietorship. Every partner is jointly and severally liable with the other partners for all debts and obligations of the partnership incurred while a partner. Further, partners are jointly and severally liable in respect of any wrongful acts or omissions by any partner acting for the partnership and for the misapplication of any money or property received for, or in the custody of, the partnership.

To be "severally liable" means that a partner can be sued independently for the whole amount of the loss. That partner would then have to go after the other partners to recover whatever contribution they were supposed to make under the partnership agreement.

To protect yourself from this situation, maintain an active role in the partnership. If you sit back and trust others to run the business, you may end up paying when the creditors come knocking.

A limited partnership, on the other hand, protects the limited partners from the claims of creditors. A limited partnership consists of one general partner and many more limited partners. The general partner

is responsible for the control and management of the business. Limited partners must not take part in the control of the business but can inspect the partnership books, receive full information of the partnership's affairs, and perform some other limited activities.

The big advantage of a limited partnership is that the losses of limited partners are restricted to the amount of their investment in the partnership. They are not responsible for partnership debts in excess of their monetary contribution to the partnership. As an example, if a limited partner contributed \$10,000 to the purchase of a horse racing operation and the racing operation lost money and owes \$100,000 to creditors, the limited partner will only be at risk of losing the \$10,000 already contributed to the partnership rather than being responsible for the entire debt.

Limited partnerships are expensive to create. You will need a lawyer or an accountant to produce the documents required to go this route.

4. CORPORATIONS

One or more individuals can incorporate a company to carry on business. A company has its own legal personality distinct from its owners. As such, it can sue or be sued in its own name, enter into contracts, own property, and remain intact through the deaths of its owners or the transfer of the business to new owners. It has all the powers and obligations of an individual to carry on business.

Unlike a partnership or sole proprietorship, a company does not exist until it is properly registered with the appropriate government agency. The most important document to be filed is the company's Articles of Incorporation, setting out the name of the company, its share capital and restrictions on transfer, the number of directors, and any restrictions on the business to be undertaken. The name of a company will include the word "limited" or "incorporated" or an abbreviation thereof to inform third parties that they are dealing with a company.

The shareholders of a company are not liable for the debts or other obligations of the company. As such, if the company has several creditors and no funds to make payment, the owners, with limited exception, can walk away from the situation with their personal assets intact. This contrasts with the operation of a sole proprietorship or a partnership where personal assets can be seized to satisfy the debts of the business.

Obviously, limited liability is a great advantage for the owners of a business. In some situations, courts are willing to look behind the corporate veil and hold directors or shareholders liable for certain claims

against the company. Employees can hold directors liable for unpaid wages. Some legislation makes directors and senior executives liable for certain offences, such as environmental offences. Adequate insurance coverage is still important.

When making a regular profit, there are tax advantages to using a company. An incorporated Canadian business claiming the small business tax deduction pays a significantly reduced income tax rate when compared to an individual. Shareholders often leave their profit to be reinvested in the corporation to take advantage of the tax savings. There are also tax savings on the sale of shares in the business.

Disadvantages of carrying on business through a company include the start-up costs for the incorporation and the yearly red tape. Filing fees across Canada are at least a few hundred dollars and a lawyer should be retained to organize the documents required for filing. It is recommended that an accountant be hired to review the books annually to ensure compliance with all laws, federal and provincial, and to ensure that full advantage is being taken of any tax savings. For a short-term business or one that is not expected to produce much profit, it may not be worthwhile to incorporate.

5. CO-OWNERSHIP AGREEMENTS AND HORSE SYNDICATIONS

A growing trend in the industry is the ownership of quality horses by groups of people. Multiple ownership of horses, or horse syndications, makes accessible to the regular folk the quality of horses previously reserved for the more fiscally endowed.

There is no magic to co-ownership agreements or horse syndications. Investors come together to perform a venture, whether it be the purchase of a racehorse, stallion, or horse operation, with a view to making a profit on the investment. It is a business. Multiple owner agreements can take many forms, from a simple contract between two friends for the purchase of a horse, to a limited partnership, corporation, trust, joint venture, and a variety of other vehicles. Each has its own special rules and the choice of vehicles should be carefully considered before any money is expended on the venture.

Care should be taken to consider not just the start-up funds required from the investors but also the ongoing yearly maintenance costs for running the business. A racehorse can cost up to \$40,000 per year to maintain. It is useful to ask investors up front for ongoing maintenance costs for at least a year in addition to the start-up costs required for the

investment. It is also useful to designate one member as the manager of the syndicate tasked with decisions regarding routine financial outlays and the horses.

6. PUT IT IN WRITING!

Whatever the arrangement, there is one cardinal rule that should be observed to make the venture a successful one: PUT YOUR AGREEMENT IN WRITING. If you are entering a horse business with a friend or business associate, I cannot stress enough the importance of setting some basic guidelines in writing for the relationship. Business relationships have a way of falling apart when things go wrong. Disagreements between co-owners regarding the maintenance or sale of a horse may quickly deteriorate and the resulting dispute could harm the position of all parties involved as well as end friendships, increase cost, and precipitate court action. The written agreement should include the following information:

- It should indicate what each of the owners contributed to the purchase or creation of the business, whether that contribution was financial, or through expertise on horses, and the ownership percentage of each owner.
- It should indicate who pays for the upkeep of the horses, training, showing, racing, and all other expenses required to run the business.
- It should contain a dispute resolution clause, (i.e., if the owners cannot agree on an issue, there is a mechanism to break the stalemate).
- Make sure the agreement contains an escape clause. If one owner wants out, there should be a buyout clause allowing the other owners to purchase that partner's share of the business at an agreed price. Assuming the assets of the business are the horses, the agreement should also make clear the events that will trigger a sale of the horses. Many disagreements arise because one owner wants to sell a horse and the others do not. As the value of a horse can fluctuate wildly due to injury or success, the timing of a sale is very important.
- Discuss the investment with a financial professional as there are tax-planning issues that should be considered to allow for a maximum return on the investment.
- Troubleshoot. Plan for foreseeable events or problems. As they say, an ounce of prevention is worth a pound of cure.

The Self-Counsel Press website (www.self-counsel.com) offers even more downloadable agreements and contracts for your equine business.

If you love horses, why not make it into a business and earn a little cash while doing what you enjoy? It just takes a little planning.