

Horseracing's Dreams and Schemes... and the Need to Steer Clear of Both

By Chris Wittstruck



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Imagine an investment guaranteeing that either you'll become wildly wealthy or can take all your losses as tax deductions. Remember the old adage, "If something seems too good to be true, it probably is?" Well, there seems to be a common belief among those completely unfamiliar with our industry that racing is the exception to that maxim. Rags to riches stories from Seabiscuit to Rambling Willie make the idea of spinning gold from straw (and hay) quite plausible. When Jack sold his mother's cow on the way to market, he probably settled for magic beans because there wasn't an available older trotter in the vicinity.

On October 26, years of fleecing some of the most affluent folks in America culminated in guilty pleas by David Plummer, his son Spencer and C.P.A. Terry Green to Conspiracy to Defraud the United States. The scheme was massive, predictable and, you guessed it, involved the horse industry.

The three operated ClassicStar LLC, a limited liability company that maintained a Thoroughbred breeding operation in Woodford County, Kentucky and a tax shelter in Utah. Their self-styled "Mare Lease Program" purported to lease the reproductive capacity of the farm's mares, resulting in the lucky investor owning the mare's foal if one was born. Better yet, Green assisted the investors in filing tax returns that claimed massive deductions for participation in the program.

The problems? First, the deductions were fraudulent in part because the leases were financed through fraudulent loans. About half of the invested money came from an entity called National Equine Lending Co. While claiming to be independent, the entity was actually a zero-equity shell controlled by ClassicStar and fully funded by that operation. Taking a page from Ponzi schemes, funds were consistently shifted between the two entities to create the deception that loans were being satisfied. When an investor ceased participating in the program, loans were retired through fabricated trades with a front company having professed interests in, of all things, coal bed methane gas wells.

It gets worse. When the scam became so successful that ClassicStar ran out of Thoroughbred mares, they simply palmed-off cheap Quarter Horse mares to the scheme's unwitting backers. Given the popularity of what was for a time considered an extremely innovative investment, it's a wonder that the scammers provided any real, live horses at all. Then, when the house of cards finally began to fall in the form of formal inquiries by Uncle Sam, Green graciously assisted customers in their IRS audits by creating false and back-dated documents and presenting them to IRS auditors. In fact, many investors received tax refunds, including refunds for years prior to their investments.

By February 2006, when a search warrant was finally executed at the farm, the investors in the Mare Lease Program had filed tax returns with the IRS claiming false tax deductions of over \$500 million, which resulted in a tax loss to the Government of over \$200 million. Needless to say, several civil suits are pending against ClassicStar, the three principals that ran it, and other firms, including a variety of investment advisors. What drove investors and advisors to the scheme? The answer is easy: the desire to make windfall profit with little downside risk, given the supposed highly favorable tax treatment the investment would enjoy.

The lessons of ClassicStar are straightforward and easy to comprehend:

1) You will meet some of the best people you will ever know in the horse industry; but maybe some of the worst. No segment of the population is without those who fail to play by all of the rules all of the time. Knowing who you are dealing with requires a high degree of due diligence. That means asking pointed questions, get straight answers, and asking more questions based upon those answers. If the answers ring hollow, or the answerer seems perturbed, congratulations; you get a chance to escape this proposed investment, relationship, etc.

2) Folks tell you that many racehorse and breeding investments are great tax shelters; and they're right. What they don't tell you is that the I.R.S. disallows tax shelters as attempts to conceal taxable income. Losses from your racehorse investments do not meliorate tax liability attributed to your active income unless you materially participate (not just sit around and wait for checks) and run the investment like a for-profit business.

3) More people lose money investing in racehorses than profit. While profits from racehorse investment can be astronomical, consider that for every trotter crop produced, only one horse wins the Hambletonian. There are only a finite number of big money opportunities that can serve to offset breeding and other acquisition, training, veterinary, staking and related costs. There are many more strikeouts than homeruns.

4) Racehorse ownership and breeding are disposable income investments. Unless you are ridiculously wealthy, your investment should be limited to that which you would spend on such endeavors as travel and entertainment. Racehorse investment is an alternative to buying a power boat, R.V. or vacation home. You don't invest the money earmarked for your child's college tuition in a four-legged operation. There are hundreds of folks who lost their entire life savings with Madoff Investments just in the New York metropolitan area alone. The high level of incumbent risk in racing and breeding is real and ever present.

5) Most folks, especially first timers, should consider fractional share ownership of a horse or horses. Owning just a small percentage of a horse brings the same pride of ownership and associated benefits with an extremely limited amount of exposure. The camaraderie that develops in multiple ownership arrangements is often a benefit that is realized irrespective of the horse's prowess. Moreover, for the serious investor, having 10% of 10 horses instead of all of one is the type of diversification that would appear prudent within any class of investment. That's why people buy mutual funds – diversify and minimize risk.

This morning, the first of almost 1,100 yearlings are scheduled to go through the sales ring at Harrisburg. Dreaming about snaring a future multiple stakes winner for a paltry hammer price is what this sport is all about. Knowing the real likelihood of that happening, and all the potential financial downside, including the rules regarding tax treatment of loss, is what makes your purchase at any level a responsible, informed investment. Know your limits, develop a game plan, check with people you've thoroughly checked out, and go in with the comfort of knowing that, win or lose, you've made a solid business decision that will bring you much satisfaction.

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