AlpacaGram 3.81 — Things to Consider When Starting or Operating an Alpaca Related Business: Part 2 of 3

Posted: Wed, August 24, 2016

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THINGS TO CONSIDER WHEN STARTING OR OPERATING AN ALPACA RELATED BUSINESS

A THREE-PART SERIES FROM GIRCOM

Read Part One **Online**

PART TWO

This is a continuation of the "Things to Consider When Starting or Operating an Alpaca Business" series. The IRS nine-factor test is a list of things to keep in mind when making business decisions. If you get audited, as we mentioned in Part One, the most likely manner of the audit will be correspondence. The nine factors almost always are brought up in the correspondence as questions about your operation.
The section on land use is intended to be a reminder of all the things you should be informed about before you bring your first alpaca home. If you relocate, these are things you should check into before you sign a purchase offer.

1. The factors (called the 9 factor test) the IRS considers when determining whether you are engaged in a business or a hobby are:
    a. Manner of business. The IRS has asserted that tree farming, horse breeding, and similar businesses were hobbies rather than businesses. At one time, tax auditors were advised that alpacas were "exotic" animals and raising them was not a mainstream livestock business. Many states have specifically changed the status of alpacas and llamas to "livestock" and in

a footnote in a bill a few years ago, congress referred to alpacas as livestock. This provides a basis for arguing that raising alpacas is a business.

b. Expertise of taxpayer. An agricultural background helps, of course, but attending the many types of animal husbandry, genetics, fiber, business, and other courses offered by AOA can be proof that the taxpayer is acquiring the necessary expertise.

c. Time and effort involved. Most of us work very hard and long hours making our business successful. Those who agist their animals must still materially participate in taking care of the animals, making breeding and marketing decisions, and even shoveling poop.

d. Expectation of assets appreciating. If we expect our alpacas to appreciate, it looks like an investment rather than a business. On the other hand, we would expect a breeding animal to appreciate if it wins show ribbons, has winning offspring, and has superior EPD statistics. This is something that must be carefully explained to an auditor or tax preparer.

e. Success in similar or dissimilar activities. Someone who was successful at breeding dogs, for example, might be expected to be successful at breeding alpacas, as some of the same skills would be used. Business success is considered predictive of success in general, since no one, presumably, would get involved in a business with the intention of losing money. On the other hand, someone with a successful professional career might want to offset some of his/her tax burden with an enjoyable business that generates tax losses. These things have to be weighed.

f. History of income and losses. The IRS presumes that you are engaged in business if you make a profit in two years out of every five. (But this merely means in that event, you don't have to prove to the IRS that you are in business). Conducting your alpaca business in a businesslike manner can also prove you are in business without necessarily showing a profit. What matters is how the business is conducted. Business plans, P&L statements, balance sheets—all play an important part.

g. Amount of occasional profits. There could be a problem if you never, ever report any income. Even if you don't make a profit, you should have some income or you risk the appearance that you are not engaged in a business.
h. Financial status of taxpayer. On occasion, the IRS has challenged a taxpayer who has a lot of income and a lucrative, full-time job as not being in business. A tax court case a few years ago involved a lawyer with a full-time law practice who was also a tree farmer. You may disagree that a professional person cannot also be in the business of tree farming, but be aware this kind of situation can invite scrutiny.
i. Elements of personal satisfaction or recreation involved. This ninth factor hearkens back to the horse-breeding cases the IRS won in the 70s and 80s. (A breeder whose kids are active in 4-H may need to watch out for this one.)
   If you love to ride horses, the IRS reasons that you may be getting more out of it than a person who is in business should be. Recently, the Third U.S. Circuit Court of Appeals (which covers Pennsylvania, New Jersey, and Delaware) gently ridiculed the recreational factor as applied by the IRS to horse training, so there may be possible changes to this factor in the future—but the remaining circuits have not weighed in on this case yet, and may disagree. The IRS can disregard this case in all circuits but the third.

2. Hobby losses: You can still deduct losses if you are engaged in a hobby, but only to offset any money you earn. Most breeders with actively earned income from another job or business want to offset some of that. Engaging in the legitimate business activity of raising alpacas and producing products from their fiber, with the intention of making a profit, is a good way to do that.
3. Some general comments about conservation easements: The tax code allows people to deduct the value of conservation easements in many places (adjacent to public land, for example). This is usually determined by subtracting the "after easement" value of the land from the "before easement" value. These are very tricky and require good legal and tax advice to accomplish, but can be worthwhile as a way to reduce one's tax burden.

PART III WILL ADDRESS ZONING, COVENANTS, AND SOME BASIC CONCEPTS OF CONTRACT LAW.

*** This article is not intended to provide legal or tax advice. You should consult your own lawyer or tax adviser for advice specific to your own circumstances**

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