

# Tax Strategies

for

## Alpaca Breeders

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Presented by:

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A copy of this presentation  
is available at [www.kershawassoc.com](http://www.kershawassoc.com)

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## **About the presentation**

The purpose of this presentation is to explain some of the methods available to farmers & breeders to help reduce their income tax burden. Most of the topics discussed apply not just to farmers, but to many small businesses. Alpaca breeding, however, lends itself particularly well to many of these techniques. Topics covered include:

- Capital Gains vs. Ordinary Income
- Depreciation and Section 179
- Farm Income Averaging
- Audit Preparation & Business Planning
- Donating Animals to Charity
- Benefits of Adding Children/Spouse to the Farm Payroll
- Explanation of Sale Configurations
- Product Review: AlpacaEase Software

Several topics are supported by tax planners and/or actual tax forms to help illustrate the concept. Our goal is to educate local alpaca breeders about some of the choices available to them as they build their farm, as well as some of the pitfalls they should avoid along the way.

## **About the speaker**

Matt Bannon is an Enrolled Agent and Licensed Tax Consultant with Kershaw & Associates, Inc. When not preparing individual and business tax returns, he helps clients with tax planning issues, computer applications, general accounting, and QuickBooks procedures. Outside interests include wine-making, mountain climbing, and raising a family (not necessarily in that order).

## **About our company**

Kershaw & Associates, Inc. is a family-owned company located along the Willamette River just blocks from downtown Portland. We focus on building long-term relationships with our clients, in many cases preparing returns and advising second- and even third-generation customers! As a small company we remain highly flexible, with consultations often taking place on weekends or at the client's home or place of business. We have built a niche by striving to reach a balance between our information needs as tax advisors and our clients' needs in all their various walks of life.

## Capital Gains vs. Ordinary Income Leveraging Tax Rates

If an animal is raised or purchased with the intent to sell that animal in the future, the gain on the sale is ordinary income and is reported on Schedule F. Any profit is subject to both income tax and self-employment tax (Social Security and Medicare). On the other hand, if the animal is raised or purchased in order to build or improve the quality of the herd and the animal was not intended to be sold, the animal is now a business asset similar to farm equipment, fences, and other items not intended for sale. Later, if the animal no longer meets the requirements of the herd and is sold, the gain in excess of depreciation recapture is converted from ordinary income to capital gain. Significant tax savings result from structuring animal sales as capital gains rather than ordinary income. Long term capital gain tax rates are lower than ordinary tax rates and no capital gains (long or short term) are subject to self employment taxes (Social Security). It is important, however, to understand the nature of each.

Remember that to be treated as capital gain, an animal must originally be acquired or raised with the intent it will be a permanent part of the herd. Since substantial tax savings can be realized when these animals are sold, it is crucial that you demonstrate to the IRS an understanding of this concept. If the animal truly was not a farm asset, report the sale on Schedule F where it belongs. For animals treated as assets, keep records detailing the qualities that justify this treatment. These records are especially important if a herd animal is sold without having been actually bred within the herd.

Assuming an animal sale meets the criteria of a capital gain, the timing of the sale can be crucial. If you sell an asset held one year or less, the gain is considered short term capital gain and is subject to ordinary income tax rates (but not self employment tax). Only by holding the asset *more than one year* is the gain eligible for the lower rates of long term capital gains. The second and third columns on the next page show you the difference a day can make. Column two includes capital gains for assets held up to one year. Column three shows the gain if the assets were sold one day later (a year plus a day). The first column calculates the tax if all the sales are reported on Schedule F.

## Capital Gains vs. Ordinary Income

**Case 1:** \$20,000 Self-Employment (SE) income

**Case 2:** \$20,000 Short Term Capital Gain (STCG)

**Case 3:** \$20,000 Long Term Capital Gain (LTCG)

	Case 1 <b>SE Income</b>	Case 2 <b>STCG</b>	Case 3 <b>LTCG</b>
2004/MFJ/4 Exemptions			
<b>Income:</b>			
Wages	30,000	30,000	30,000
Interest & Dividends	1,000	1,000	1,000
Self-employment Income	20,000	0	0
Capital Gains & Losses	0	20,000	20,000
<b>Total Income</b>	51,000	51,000	51,000
<b>Adjustments:</b>			
Self-employment Tax & Other Adjs	1,413	0	0
Total Adjustments	1,413	0	0
<b>Adjusted Gross Income</b>	49,587	51,000	51,000
Personal Exemptions	12,400	12,400	12,400
Standard Deduction	9,700	9,700	9,700
Total Deductions from AGI	22,100	22,100	22,100
<b>Taxable Income</b>	27,487	28,900	28,900
Regular Tax:			
Schedule or Table Tax	3,408	3,620	3,620
Alternative Capital Gains Tax	0	0	1,890
Self-employment Tax	2,826	0	0
<b>Total Federal Taxes</b>	6,234	3,620	1,890

## Farm Depreciation

Depreciation is a concept that takes some getting used to. The basic idea is that when you purchase a piece of equipment, that equipment will be used to generate income over several years. You are therefore required to spread the cost of that equipment over several years in order to more accurately match the cost with the income being produced. For tax purposes, the IRS has established guidelines to determine the number of years different items should be depreciated over. For example, most animals (including alpacas) should be depreciated over 5 years, fences over 7 years, general-purpose farm buildings over 20 years, etc.

Most business owners are probably familiar with Code Section 179, which allows you to expense a portion of these assets up front. Through the end of 2004, Section 179 states that if you purchase up to \$400,000 of assets during the year, you may elect to expense up to \$100,000 currently. Any remaining basis in the asset should be depreciated over the normal life. On January 1, 2005 the deduction is scheduled to return to its pre-9/11/01 limit of \$25,000 for businesses that purchase up to \$200,000 for the year.

### **2004 Example:**

John buys an alpaca for \$40,000  
He elects to expense \$30,000 under Section 179.  
He will depreciate the remaining \$10,000 over 5 years

### **2005 Example:**

John buys an alpaca for \$40,000. He elects to expense \$25,000 (limit) under Section 179. He will depreciate the remaining \$15,000 over 5 years.

For new assets (first use, not "new to you") placed in service after September 10, 2001 but before January 1, 2005 there is an additional deduction available. For these assets, depreciation is 30% or 50% (30% before May 6, 2003, your choice after) of the basis remaining after any Section 179 deduction.

### **2004 Example:**

John buys an alpaca for \$55,000 on 10/31/04  
He elects to expense \$10,000 under Section 179  
He then elects to claim the 50% special depreciation allowance (\$22,500)  
He will depreciate the remaining \$22,500 over 5 years  
Total first-year depreciation \$37,000 (\$10,000 + \$22,500 + \$4,500)

Section 179 is claimed asset-by-asset, while the special depreciation allowance is claimed by class (ALL 5-year property or ALL 7-year property, etc). Only assets with depreciable lives of 20 years or less qualify for the special

depreciation allowance. Presently a gray area exists in applying the 30% or 50% bonus depreciation deduction to breeding animals; when is an animal “new” vs. “used?” It is our belief that a raised animal will qualify for the deduction until it is bred for the first time. We also feel that a bred female (first breeding) will qualify if the mother-baby combination is sold together within a reasonable period of time after birth.

When you sell an asset that has been partially or fully depreciated, it may be necessary to recapture a portion of the depreciation taken. Think of it this way: you bought an asset and used a portion of the cost to offset taxable income. You have thereby reduced your basis in the asset. If you then sell the asset for an amount higher than the adjusted basis, you must add back to ordinary income the depreciation (including Section 179) to the extent of the gain. Also, if an asset falls to less than 50% business use (a vehicle, for example), any Section 179 taken must be recaptured to the extent it exceeds the regular depreciation which would have been allowed. The 30% or 50% bonus depreciation is not subject to this rule, as it is considered part of the normal depreciation. PLEASE NOTE: Any depreciation recapture is reported as income in the year of sale regardless of the amount of cash received. Keep this in mind as we explore the potential leverage of installment sales in the following example .

### **A Win-Win Example**

The power of the leveraging options open to farmers can be seen in the following scenario:

Farmer John sells Breeder Bob a raised herdsire for \$50,000 on December 31, 2004. The contract requires a \$5,000 down payment, balance to be paid in equal installments over 3 years. As the new owner, Bob is entitled to expense the entire \$50,000 purchase price under Section 179 on his 2004 tax return. Farmer John, meanwhile, can elect to report the sale on the installment method, thereby paying tax on just \$5,000 of income in 2004. As a raised herdsire over 1 year old, John’s income is taxed at the reduced long term capital gains rate, while Bob gets the deduction at the higher ordinary income tax rate and only has to come up with \$5,000 of cash to do it.

## Farm Income Averaging

Farm income often swings dramatically from one year to the next. The sale of even a single champion alpaca can send your farm income (and therefore your tax liability) soaring. By moving the farmer into the highest tax rate every few years, these wild swings mean the farmer will pay more taxes than a person with a steady income stream over the same period of time. This is true even if the two taxpayers had the same aggregate income over the years.

Congress eventually took notice of this and passed a law allowing farmers to spread their income over the three previous years in order to smooth out the spikes in their income. The best part is that the law allows the farmer to pick and choose which income to carry back. Any farm-related income is eligible, including capital gains, ordinary income, depreciation recapture, etc.

We have included two pages to illustrate the usefulness of farm income averaging. The first sheet presents the taxes due over a four-year spread if no averaging is elected. We also prepared and included an actual Schedule J for John Q. Farmer to show the tax savings if averaging is elected. The important numbers to note appear at the bottom of Schedule J. Without income averaging, John's federal tax bill for 2003 would be \$11,414. After spreading just under fifty thousand dollars of 2003 income over the three preceding years, his 2003 tax bill is now \$9,376, saving him \$2,038. It is interesting to note that the current environment of low tax rates preceded by several years of higher rates has substantially reduced the effectiveness of income averaging. As the rates in the "base" years drop, Schedule J will become a powerful tool again.

Although Schedule J can be a difficult form to navigate, the plus side is that no amended returns are necessary; the entire process takes place on Schedule J of the current year's tax return. It is possible to elect farm income averaging on an amended return (for example, if you decide after your return is filed that you should have elected income averaging), but only if at least one other change is being made.

**When should you consider farm income averaging?** Any time your farm-related income takes a sharp spike upward. The keyword is *farm-related*. For instance, the sale of your fully-depreciated farm truck for \$30,000 qualifies for farm income averaging.

## Farm Income Averaging

	2000	2001	2002	2003
MFJ/2 Exemptions				
<b>Income:</b>				
Wages	30,000	30,000	30,000	30,000
Interest & Dividends	1,000	1,000	1,000	1,000
Self-employment Income	-10,000	0	10,000	60,000
<b>Total Income</b>	21,000	31,000	41,000	91,000
<b>Adjustments:</b>				
Self-employment Tax & Other	0	0	707	4,239
Total Adjustments	0	0	707	4,239
<b>Adjusted Gross Income</b>	21,000	31,000	40,293	86,761
Personal Exemptions	5,800	6,000	6,100	6,200
Standard Deduction	7,600	7,850	9,500	9,700
Total Deductions from AGI	13,400	13,850	15,600	15,900
Taxable Income	7,600	17,150	24,693	70,861
<b>Tax:</b>				
Schedule or Table Tax	1,211	2,644	3,364	11,414
Self-employment Tax	0	0	1,413	8,478
<b>Total Federal Taxes</b>	1,211	2,644	4,777	19,892

**SCHEDULE J  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Farm Income Averaging**

G Attach to Form 1040.

G See Instructions for Schedule J (Form 1040).

OMB No. 1545-0074

**2003**

20

Name(s) shown on Form 1040

Social security number (SSN)

**John Q. and Jane Q. Farmer**

1	Enter the taxable income from your 2003 Form 1040, line 40 .....	1	<b>71,161.</b>
2	Enter your <b>elected farm income</b> (see instructions). <b>Do not</b> enter more than the amount on line 1 .....	2	<b>49,500.</b>
3	Subtract line 2 from line 1 .....	3	<b>21,661.</b>
4	Figure the tax on the amount on line 3. Use the <b>2003</b> Tax Table, Tax Rate Schedules, Qualified Dividends and Capital Gain Tax Worksheet, or Schedule D, whichever applies .....	4	<b>2,551.</b>
5	If you used Schedule J to figure your tax for 2002, enter the amount from line 11 of your 2002 Schedule J. If you used Schedule J for 2001 but not 2002, enter the amount from line 15 of your 2001 Schedule J. If you used Schedule J for 2000 but not 2001 nor 2002, enter the amount from line 3 of your 2000 Schedule J. Otherwise, enter the taxable income from your <b>2000</b> Form 1040, line 39; Form 1040A, line 25; or Form 1040EZ, line 6. If zero or less, see instructions .....	5	
6	Divide the amount on <b>line 2</b> by 3.0 .....	6	<b>16,500.</b>
7	Combine lines 5 and 6. If zero or less, enter -0- .....	7	<b>16,500.</b>
8	Figure the tax on the amount on line 7 using <b>2000</b> tax rates (see the instructions) .....	8	<b>2,475.</b>
9	If you used Schedule J to figure your tax for 2002, enter the amount from line 15 of your 2002 Schedule J. If you used Schedule J for 2001 but not 2002, enter the amount from line 3 of your 2001 Schedule J. Otherwise, enter the taxable income from your <b>2001</b> Form 1040, line 39; Form 1040A, line 25; or Form 1040EZ, line 6. If zero or less, see instructions .....	9	
10	Enter the amount from line 6 .....	10	<b>16,500.</b>
11	Combine lines 9 and 10. If less than zero, enter as a negative amount .....	11	<b>16,500.</b>
12	Figure the tax on the amount on line 11 using <b>2001</b> tax rates (see the instructions) .....	12	<b>2,475.</b>
13	If you used Schedule J to figure your tax for 2002, enter the amount from line 3 of your 2002 Schedule J. Otherwise, enter the taxable income from your <b>2002</b> Form 1040, line 41; Form 1040A, line 27; or Form 1040EZ, line 6. If zero or less, see instructions .....	13	
14	Enter the amount from line 6 .....	14	<b>16,500.</b>
15	Combine lines 13 and 14. If less than zero, enter as a negative amount .....	15	<b>16,500.</b>
16	Figure the tax on the amount on line 15 using <b>2002</b> tax rates (see the instructions) .....	16	<b>1,875.</b>
17	Add lines 4, 8, 12, and 16 .....	17	<b>9,376.</b>
18	If you used Schedule J to figure your tax for 2002, enter the amount from line 12 of your 2002 Schedule J. If you used Schedule J for 2001 but not 2002, enter the amount from line 16 of your 2001 Schedule J. If you used Schedule J for 2000 but not 2001 nor 2002, enter the amount from line 4 of your 2000 Schedule J. Otherwise, enter the tax from your <b>2000</b> Form 1040, line 40*; Form 1040A, line 26*; or Form 1040EZ, line 10 .....	18	
19	If you used Schedule J to figure your tax for 2002, enter the amount from line 16 of your 2002 Schedule J. If you used Schedule J for 2001 but not 2002, enter the amount from line 4 of your 2001 Schedule J. Otherwise, enter the tax from your <b>2001</b> Form 1040, line 40*; Form 1040A, line 26*; or Form 1040EZ, line 11 .....	19	
20	If you used Schedule J to figure your tax for 2002, enter the amount from line 4 of your 2002 Schedule J. Otherwise, enter the tax from your <b>2002</b> Form 1040, line 42*; Form 1040A, line 28*; or Form 1040EZ, line 10 .....	20	
* <b>Do not</b> include tax from Form 4972 or 8814 or from recapture of an education credit. Also, <b>do not</b> include alternative minimum tax from Form 1040A.			
21	Add lines 18 through 20. .... <b>Regular Tax</b> .....	21	<b>11,414.</b>
22	Subtract line 21 from line 17. Also include this amount on Form 1040, line 41. ....	22	<b>9,376.</b>

**Caution.** Your tax may be less if you figure it using the 2003 Tax Table, Tax Rate Schedules, Qualified Dividends and Capital Gain Tax Worksheet, or Schedule D. Attach Schedule J only if you are using it to figure your tax.

## Audit-Proofing

There is no such thing as being “audit-proof.” There are, however, things you can do to greatly improve your chances of a favorable outcome. Most of the ideas we present here can be lumped under the general category of “putting it in writing.” Right or wrong, if you can’t prove your story true you’ll face a tough uphill battle in an audit, especially in your first few years when the farm is likely to generate substantial losses.

The Internal Revenue Code allows businesses to deduct from gross income expenses which are reasonable and necessary to conduct the business, even when the expenses exceed the income. It also defines the criteria used to determine whether an activity is a business (i.e. engaged in for profit) or a hobby (i.e. not engaged in for profit even though occasional profits may result). Most farm audits center on this key issue. Presenting an auditor with the following items will shift the burden of proof from you to the auditor, instantly changing their position from the offensive to the defensive and giving you a much better chance of walking away unscathed.

**Time Log** – A daily, or even weekly, journal of the time dedicated to your farm is more than just a good audit tool, it’s good business sense. You need to know whether your efforts are worth the rewards. Keep a simple log and make every effort to note how many hours are spent in each major category of farm activities. Don’t forget to include time spent conducting research on the internet, buying supplies, visiting other farms, and even the time spent tracking your time! Also, be sure to track the time your spouse spends on the activity as this can be included with your time for audit purposes.

**Business Journal** – Keep a journal of key events or decisions related to the farm. These records could be especially useful in conjunction with a well-maintained business plan (see next section). More importantly, it is difficult to remember every decision you make over the years and virtually impossible to remember *why* you made them.

**Animal Stat Sheets** – A prudent business-person tracks which products or services are profitable and which need improvement. Maintain a “stat” sheet for each animal listing the sire and dam, offspring, awards, income from breeding, sales of offspring, etc. To succeed in business it is critical that you know where to focus your energy and presenting evidence of this effort in an audit can make all the difference.

**Mileage Log** – Mixed-use vehicles (vehicles used for both business and personal miles) receive careful scrutiny by the IRS. A log book supporting your automotive expenses can be a tremendous help in an audit, especially if you’ve

taken a large depreciation deduction on a truck or SUV. For vehicles used primarily for the farm it may be easier to track personal miles and subtract these from the total miles at year end. A separate log should be maintained for each vehicle.

**Phone Log** – Maintain a notebook near each phone or carry one with you for cell phone calls. Each time you discuss farm issues note the date, subject, and the name of who you talked to. Also jot down a brief summary of the conversation. Besides substantiating your efforts in an audit, this log can serve you well should a conflict arise later about the details of a conversation (the terms of an animal sale, for example).

**Marketing** – Keep samples of brochures, newspaper ads, or any other printed media that can help you prove you've been marketing your product. A simple one- or two-page website is inexpensive and can be very persuasive in an audit. Jot down word of mouth marketing in your farm journal. An example entry might read "*July 24, 2004 – AROW Show. Received tax advice for breeders/also discussed potential market for bred silver female with Tom Farmer and Bob & Betty Breeder.*" In the first few years of your breeding program you may not be inclined to sell your animals, but you probably would for the right price and it is vital that you be able to show you were trying. Also, be sure you know what the market wants and where it's headed. If your animals don't meet the current market demand, are you changing the makeup of your herd? If not, do you have a good reason for bucking the trend? Asking yourself these questions each year is good business sense and *that* is what the auditor is looking for.

**Books & Records** – Auditors tend to place a lot of emphasis (we feel too much) on the condition of the business owner's books and records. It is virtually impossible to track your profitability from a shoe-box of receipts and auditors like to use this as evidence that you don't *care* if you make a profit and are therefore a hobby, not a business. A well-maintained Profit & Loss statement makes a good first impression. A separate business checking account is not required, but can be quite helpful. Auditors will sometimes compare the deposits on your bank statements to the income reported on your tax return. Having a separate business account could make this process much easier. Above all, be sure to write down your goals, particularly how and when you think you will turn a profit and UPDATE IT ANNUALLY. Auditors often use "lack of a written business plan" as evidence of a lack of profit motive. The next page presents a general guideline for maintaining a business plan.

Are all these logs and records a lot of work to set up and maintain? You bet they are, but who ever said running a business is easy? Few people would make this kind of effort for a hobby, which is precisely why it can save you in an audit.

## Building a Business Plan

A business plan is a roadmap to keep you from losing sight of your objectives. As your objectives change, your business plan should reflect that. A clear, realistic business plan is a powerful tool as you build your farm. It can also make a strong first impression when presented to a banker, auditor, or other interested party. Be sure to update your plan at least annually and *keep your previous plans* with your business records.

### Five simple steps to create your business plan:

1. Review prior year(s) plan (N/A first year)
  - a. Goals and timeline met? If not, why not?
  - b. What worked, what did not?
2. Determine current financial position
  - a. YTD gross income, net income
  - b. Adjust for unusual or non-recurring items
  - c. Is there a discernible trend over recent years?
  - d. Balance Sheet review (assets vs. debts)
  - e. Asset values appreciating or declining?
3. Determine short term and long term goals
  - a. Set specific target numbers and dates for short term goals
  - b. Long term goals should be more general
4. Steps to achieve goals
  - a. Brainstorm: Adding or removing products or services offered, exploring new markets, adjusting advertising methods, acquiring new equipment or technologies, personnel changes, borrowing funds, exploring partnerships, etc.
  - b. Determine feasibility of above
  - c. Set timeline to reach specific goals
5. **Keep your current business plan in front of you!** Post the plan in a conspicuous place, don't just file it away. Also, bring your plan with you each time you meet with your tax or business advisor.

Remember, your business plan is a guide to where you're going, but it can also serve as a map of where you've been. A decision which appears foolish in hindsight probably made perfect sense when it was made. Should anyone ever challenge your business savvy (such as a bank, the IRS, or yourself) your old business plans could prove invaluable.

## Donating Animals to Charity

Most of us have no problem figuring the tax deduction when cash or clothing is donated to a charitable organization. But what if the item donated is an animal? Here the rules get a bit more complex.

If the animal is being held for resale (product inventory), your deduction will be the cost of the animal. This includes only the purchase price, not the expenses of feeding and raising the animal. Those expenses were already deducted on Schedule F, or at least they should have been. If the animal was born on your farm, you have no basis and therefore receive no deduction for donating it.

Animals held as assets used in a trade or business are treated differently. Here you can deduct the fair market value of the animal, less the depreciation allowed or allowable. Fair market value is the price an unrelated buyer would be willing to pay for the animal. Notice that you must reduce this by any depreciation allowed *or allowable*. Whether you actually claimed a depreciation deduction or not is irrelevant. All things being equal, the best animal to donate is one born on the farm (no basis = no depreciation to recapture) and held as an asset. In this case, you can deduct the full fair market value of the animal.

Charitable deductions of over \$5,000 must be accompanied by a qualified appraisal. The best appraiser is probably another alpaca breeder, particularly one who is qualified as a judge. Contributions over \$5,000 are listed under Section B.

If you are considering donating an animal for a large tax write-off, be sure to plan carefully. Charitable deductions are limited to 50% of your adjusted gross income. If your farm incurs a large loss for the year, your contribution may be limited or even suspended entirely (the disallowed portion carries forward to future years). On the other hand, high adjusted gross income could also limit your deductions. Talk to your tax advisor *before* donating the animal.

## Effect of Adding Spouse/Children to Payroll

Adding your spouse and/or children under 18 to payroll can result in significant tax savings. The gross salary is deductible on Schedule F, thereby reducing both income tax and self-employment tax. If the children's total annual salary is kept under \$4,850 and they generate no other income, they will not have to file tax returns as they would fall under the standard deduction for the year. Additionally, the child now has earned income and is eligible to contribute to an IRA (\$3,000 max for 2004) or their own college fund. This can be a powerful savings tool.

It is important that the spouse and children actually perform real services for the salary, otherwise the IRS could deny the deduction. Even a young child, however, should not have a problem earning \$4,500 on the family farm throughout the year. To substantiate the payroll, keep a log of hours worked, services performed, and a record of how the rate of compensation was determined.

For couples with no employer-provided medical insurance, the benefits of adding the spouse to payroll can increase dramatically. By adopting a medical reimbursement plan through Bizplan/Agriplan or a similar program, the farmer (the employer) can offer medical insurance to the spouse (the employee). The spouse can then elect to cover the entire family, *which includes his/her spouse*. Under this setup it is possible to deduct most medical expenses against farm income rather than as itemized deductions where they would be subject to the income limitations.

### **Advantages & Disadvantages of adding spouse/children to payroll:**

#### Advantages:

- Reduces taxable income on parents' return
- Possible to incorporate medical reimbursement plan
- Teaches children to work & save (hopefully)

#### Disadvantages:

- Worker's Compensation insurance required in certain circumstances
- Must file quarterly payroll reports and W-2's
- Cash outlay required

## Effect of Adding Spouse/Children to Farm Payroll

- Case 1: No Payroll, \$20,000 Farm Profit  
 Case 2: Pay 1 Child \$4,500 Farm Wages  
 Case 3: Pay 2 Children \$4,500 Each  
 Case 4: Pay 2 Children + Spouse & Add \$5,000 Medical Reimbursement

	Case 1 No P/R	Case 2 1 Child	Case 3 2 Children	Case 4 Add Spouse
2004/MFJ/4 Exemptions				
<b>Income:</b>				
Wages	30,000	30,000	30,000	34,500
Self-employment Income	20,000	15,500	11,000	1,500
<b>Total Income</b>	50,000	45,500	41,000	36,000
Adjustments:				
Self-employment Tax & Other Adjs	1,413	1,095	777	106
<b>Total Adjustments</b>	1,413	1,095	777	106
<b>Adjusted Gross Income</b>	48,587	44,405	40,223	35,894
Personal Exemptions	12,400	12,400	12,400	12,400
Standard Deduction	9,700	9,700	9,700	9,700
<b>Total Deductions from AGI</b>	22,100	22,100	22,100	22,100
<b>Taxable Income</b>	26,487	22,305	18,123	13,794
Schedule or Table Tax	3,258	2,631	2,003	1,379
Self-employment Tax	2,826	2,190	1,554	212
<b>Total Federal Taxes</b>	6,084	4,821	3,557	1,591

## When is a Sale a Sale?

As the alpaca industry continues to grow, complex sales transactions are becoming more common. Examples include sales of partial interests in animals, sales of breeding rights, trading services for animals, etc. Following is a brief discussion of the tax implications of various sales arrangements.

**Cash Sale** – Clear cut and straightforward. The animal is paid for in full at the time of delivery.

**Installment Sale** – An arrangement in which payments for the animal span more than one calendar year. If the animal was raised and treated as a business asset (capital gain), the seller reports the income as the cash is received. For a purchased animal treated as an asset (depreciation taken), the seller recaptures depreciation to the extent of gain *in the year of sale* and the balance of income as the cash is received. In either case, the buyer begins depreciating the animal as soon as he/she is the rightful owner regardless of any debt owed.

**Barter Income** – Non-cash payments for product or services are fully taxable. The amount to be reported as income is the fair market value of the product or service received. The buyer's basis for depreciation (if applicable) is the same number. If the product or service given would ordinarily be a business expense, deduct it accordingly. CAUTION: See like-kind exchanges below.

**Sale of Partial Interest** – The sale of a partial interest in an animal is treated the same as any other sale with similar terms.

**Like-Kind Exchanges** – If you trade business or investment property for similar property (stud for stud, truck for truck, etc) you are generally *required* to report the transaction as an exchange rather than a sale. Any gain or loss is deferred and is built into the basis of the new asset. CAUTION: Always discuss any significant exchange with your tax advisor beforehand. A sale may be more advantageous, particularly for vehicles.

**Sale Date** – Report the sale the day ownership of the animal changes hands regardless of whether payment has been received and regardless of whether the animal has left your farm. A signed contract, change in title, or the buyer's assumption of risk and liability are all indications of the sale date.

**Commencing Depreciation** – Begin depreciating an asset you own when it has been placed in service. An asset is considered placed in service when it is ready and available for use. A newly purchased breeding animal does not need to be on your farm to be depreciated as long as it is ready and available for your use and you have acquired the attributes of ownership, especially the attribute of risk.

## **Product Review:** **AlpacaEase Herd Management Software**

While there are many methods available to alpaca breeders to help reduce their record keeping burden, maintaining accurate and relevant records is not always easy. Computers can be an effective tool for good record keeping but their applications are often not user-friendly. Smaller farms can easily keep good records on paper but what about larger operations? Is there an easy-to-use program that is not only relevant to the large breeder but also to the new or smaller breeder? More importantly, what records are important to keep in the first place? Several clients have recently recommended the AlpacaEase software package to us. While we do not endorse one product over another, we felt an independent review of this software might be beneficial to area breeders. Here are some of the features of AlpacaEase that can help improve your record-keeping efficiency:

- Useful Features
  - AlpacaEase features a calendar that can serve as a time log to track how much of your time is dedicated to your farm.
  - Animal summaries (stat sheets) that include DOB, color, ARI #, breed, sex, color, status, dam, and sire in addition to a complete medical, breedings/offspring, shearing/fiber, and show history.
  - A built-in mileage log can track business miles for mixed-use vehicles. Can also track more than one vehicle when appropriate.
  - Printable financial statements showing expenses, income, and P&L can make a good impression with auditors. Expenses and income can also be broken down by alpaca, payment type, vendor, and other categories. Invoice records can also be maintained.
- Records of Sales/Purchases
  - The date of sale is important for tax purposes and also maintaining accurate records. You can easily record sales and purchases of any type. This includes cash sales, installment sales, and co-ownership. You can also record the income or expense for each transaction.

Other features:

- Database of entire herd that can be sorted by sex, status, location, and breed.
- Track stud fees, confirmation dates, and due dates with daily pop-up reminders.
- Entire medical history including procedures, drugs, dosages, dates, and cost detail.
- Shearing dates, weight of fiber, and fiber analysis.
- Show dates, judges present, categories, number of entries, and awards won.
- Track up to four generations of ancestry including DOB, ARI numbers, origins, and color.
- Insurance policies, carrier, insured amounts, and term.
- Purchase/Selling information including buyer/seller, date, price, breed back information, amount paid, and balance due.

### Overall Opinion:

Navigating through the program and inputting data is fairly easy once you are familiar with the program. However, there is a learning curve. You can use the help menu for assistance but it's not necessary. What is necessary is some free time to learn and get accustomed to the program. A plus is customers get one year of support and free upgrades with purchase. All of the different modules prove useful and relevant to virtually any farm. For breeders who keep paper records, a negative aspect of the AlpacaEase software is that transferring and inputting data for more than a few alpacas would be time-consuming. This depends on the specificity of your data. If your data is well organized, the process will definitely be a lot smoother. A good estimate is that it would take approximately 5-10 minutes to input data for one alpaca depending on the thoroughness of your records. However, it is simple to input new crias into the database.

AlpacaEase could be a good tool for any operation. I cannot emphasize enough how important herd management and good record keeping are for a successful business. Admittedly, I didn't like this program upon first glance. I found myself confused by what I was viewing and impatient with the inputting process. After exploring for a couple of hours, I became more familiar with the process and my opinion changed. I realized how useful this program could be once accustomed to it. A few categories may be unnecessary but the program allows you to leave them blank if you choose. Essentially, the program is what you make of it. Larger farms may only want to keep basic records such as ancestry and breeding. Smaller farms may want to track all components of their herd as it will take less time. The bottom line is that effectively managing your herd along with good record keeping will yield greater rewards in the long-run. I recommend AlpacaEase as a good tool to help you get started.

**Cost:** \$159.00

**Download/Purchase:** You can get a free 30 day trial at [www.alpacaease.com](http://www.alpacaease.com) along with further ordering information.

**Reviewed by:** Brett Booher, Timberland Alpacas