

## **Importance of Tax Opinion Letters for Livestock Owners**

By John Alan Cohan, Attorney at Law

Livestock businesses should be operated basically in the same way as other business, utilizing business principles and judgment in decision-making, and maintaining appropriate books and records. For many ranchers, this activity is a second venture, entered into to supplement retirement income or with the expectation that assets will appreciate in value and later be sold, together with the ranch, at a profit.

The IRS has in recent years audited ranchers in the early startup phase of their activity. This presents a problem in that most people take several years before they start to realize a profit. Another problem is that in the initial stages there may be certain changes that one undergoes, certain trials and errors, so that the direction of the business might not be clear-cut. Still, under the tax regulations, for activities that including farming and livestock ventures, the general rule is that the taxpayer has the burden of proof to show that the activity is engaged in for profit, unless it can be shown that there are two profit years in a seven year period. Since many audits are conducted in the early part of the startup phase, it is not yet possible to show a profit, but the IRS will still try and find reason to declare that the venture is a hobby.

Many of my clients obtain a tax opinion letter from me in order to help withstand IRS scrutiny in the event they are audited. Tax attorneys are often called upon to draft tax opinion letters in a variety of contexts, usually in situations where the taxpayer wants expert guidance and some measure of assurance that a proposed set of facts will pass muster from a tax standpoint. Of course, it is never possible to predict how a situation will turn out in the event of an audit, but a properly drafted tax opinion letter can be a credible source of evidence that you sought out expert advice and that you followed the advice given. Also, in cases where tax opinions are rendered by a tax attorney, the IRS will be reluctant to impose penalties should the taxpayer end up being denied the tax deductions sought.

A tax opinion letter involves consultation with the client in order to ascertain the facts of the particular situation, what sort of plan the client has in mind, what has been done so far, what sort of future plans are in store. I usually want to examine certain records of the activity to make sure they are maintained properly, and determine if the land and/or livestock have appreciated in value or whether these assets are anticipated to increase in value in the future. It is important to document the increase in value of assets.

Also in the tax opinion letter, I find that clients usually want me to help articulate or restate what their business plan consists of. It is important to have a well-articulated business plan. Many Tax Court cases involving livestock indicate that one must have “some type of plan”—referring to a business plan, preferably in writing. The plan should be reviewed, updated, and amended as needed to reflect your changing circumstances and goals.

Other issues addressed in the tax opinion letter may pertain to whether the client ought to

change the manner of doing business, whether the business entity structure is appropriate for the situation, whether there can be cost-savings methods generated, and whether the business documents used by the taxpayer are in proper form.

Clients of mine who have been audited have done very well. Recently a client, who has annual updates on his tax opinion letters, was audited. The audit actually occurred in several steps that extended over the better part of the year. When the auditor saw the tax opinion letters, he recognized that the taxpayer was serious about conducting a business, even though significant losses had been generated and the taxpayer was not yet at a break-even point. When the auditor visited the ranch, it became even more clear that this activity was conducted in a totally professional, businesslike manner, and the auditor concluded that the venture was a business, not a hobby.