

## **WHAT IS A TAX OPINION LETTER?**

By John Alan Cohan, Attorney at Law

An area of concern for people in the horse, livestock and farming industries--among many other fields--is how to withstand IRS scrutiny in the event of an audit.

In judging whether you are engaged in a business rather than a hobby, one element is whether you have consulted experts so as to determine if the activity is conducted in accordance with IRS Regulations.

Tax attorneys such as myself spend considerable time in developing tax opinion letters for clients. These documents are individual to each client's situation. A tax opinion letter is usually a lengthy document. It analyzes the facts of your particular venture and makes recommendations on how best to conform with IRS Regulations. The fact that you consulted a tax attorney and obtained a tax opinion letter works in your favor in the event of an audit. It shows that you were concerned about the businesslike manner of operating your activity.

A tax opinion letter also shows that you relied on the advice of a tax attorney so that, should you lose an audit you should not be assessed negligence penalties--which can be very substantial otherwise.

Many people do not make a profit in their horse, livestock or farming ventures--and the IRS is well aware of this fact. For most people, the activity is not your primary occupation. One Tax Court case said that it would be "foolish" for a taxpayer to give up other employment until he was sure he could support himself with the proceeds from farming or livestock activities.

However, even the most considerate and compassionate IRS agent will still want to see evidence that your horse, livestock or farming activity is operated "with the intention" of making a profit, particularly if there is a history of losses. These ventures should be operated basically in the same way as other businesses, utilizing business principles and judgment in decision-making, and maintaining appropriate books and records. More so now than in the past, the IRS looks for objective facts and documentary evidence in addition to self-serving statements of the taxpayer--and a tax opinion letter is an objective item of documentary evidence that should work in your favor.

Often a horse, livestock or farming activity will start out as a hobby, and then the taxpayer will decide to transform the activity into a business. The difficulty here is documenting the shift from a hobby to a business. It is important to show that the taxpayer conducted research and investigated the feasibility of making this change, and a tax opinion letter will help to show this.

A tax opinion letter is like an insurance policy, but more than that it also helps guide you in how you go about conducting your horse activity. If you are audited, the tax opinion

letter is documentary evidence that you have sought out expert advice on how to operate the venture in a more profitable manner, consistent with tax guidelines.

Many of my clients obtain a tax opinion letter from me in order to help withstand IRS scrutiny in the event they are audited. 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, as mentioned, 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.

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.