

## Horsin' Around

Kenneth Satin, JD

With the advent of the tax "reform" acts over the last several years, the majority of previously allowable deductions have been eliminated.

One of the remaining legitimate "tax shelters" involves ranching and farming operations.

Suppose the doctor of chiropractic has excess cash he wishes to invest, but he also wants to realize tax benefits.

From a tax standpoint, real estate may not be a wise choice because of the \$25,000 annual limitation. That does not mean that it is not a good decision for other reasons, however.

Because of allowable depreciation and other benefits, ranching or farming operations may present the best possibilities from a tax perspective.

The danger is that the IRS will assert that the activity is only a hobby. The rule is that the doctor of chiropractic can deduct the expenses of his hobby only up to the amount of his hobby income. If, however, the "hobby" isn't really a hobby but actually a business, the expenses become fully deductible even against income earned from the practice.

Hypothetical 1: The practice has done well. The doctor of chiropractic has hundreds of patient visits per week. He then purchases 50 registered quarter horses and 25 thoroughbreds. He then buys a property which he converts into a ranching facility. He operates the ranch for equestrian purposes and boards horses for other people. Substantial losses are generated and he deducts those losses against the income from his practice. In this instance he might well be able to claim these deductions but runs a great risk that the IRS (or the tax court if the case is litigated) would find that he didn't honestly intend to make a profit. If that occurs, the losses would be recharacterized as hobby expenses.

There is a fine line here. The IRS will look for ways to disallow these expenses. If it can be determined that the ranch is actually operated for personal pleasure and not for a profit, the deductions will be denied.

Hypothetical 2: The doctor of chiropractic enters into a partnership with a professional horse trainer. Together they purchase the ranch with the trainer living there. The chiropractor lives 50 miles away. The chiropractor rarely rides the horses and spends little time at the facility. Several years pass. Ultimately the chiropractor sells the horses and closes shop. The fact that an arrangement was made with a professional horse breeder and trainer, and the chiropractor closed down the operation as it was not profitable, are points in favor of the chiropractor in establishing the ranch as truly a business operation. The losses should be deductible against other income.

The key is to show an intent to make a profit. There is an IRS test. If the test is passed it could be argued that, at least presumptively, the profit motive was present; gross income from the ranching/breeding operation would have to exceed the expenses for at least three out of five consecutive years or two out of seven years for breeding, training, showing or racing of horses.

*Kenneth Satin, J.D.*  
*Newport Beach, California*

Editor's Note:

Mr. Kenneth A. Satin's law firm is located at 4000 McArthur Street, Suite #950, Newport Beach, California 92660 (714) 851-1163. We thank Mr. Satin for providing this series of articles for our readers.

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