

Aviculturist's Valuable Information

IRS AND THE AVICULTURIST

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Several calls for action have gone forth among the bird world. One deals with the federal government not loaning funds under the disaster relief management programs for aviculture. The second has to do with the massive disappointment among aviculturists that only 88 responses were forwarded to Fish & Wildlife concerning the draconian regulations passed for breeding consortiums under HR 5013. Both of these concerns required aviculturists to write letters to congressmen, Fish & Wildlife and other interested parties. In other words: publicize their existence.

These seemingly unrelated problems have a common and unexpected nexus. In each case the cause, and to a certain extent the result, is dictated by the low compliance of aviculturists with reference to the federal tax laws. How so? No one actively avoiding paying their taxes can afford to be publicized by writing letters. A deceptively simple problem, yet also very complex as to its magnitude. The problem originated at the very inception of aviculture as an industry, and now is like a roller coaster most people are afraid to get off.

Obviously, the federal government would be acting irresponsibly in loaning money to businesses that haven't filed their tax returns reflecting profit, and more importantly where there exists insufficient national information regarding the financial aspect of the industry. Aviculture could very well be the only industry nationally that could be measured in the aggregate in the billions of dollars a year (capital asset base and revenues) where the number of tax returns on this revenue

could measure only in the hundreds.

The aviculture industry hasn't been singled out for adverse congressional actions. When information is pulled from the government's records reflecting the size of our industry, this is based primarily on industry codes provided by the Treasury Department whose compilations come directly from the Internal Revenue Service via Schedule C for Sole Proprietorships or Schedule F for Farms and Ranches. If aviculturists do not comply with the tax laws, and do not file tax returns, then our industry looks deceptively small. The nature of politics dictates that financially insignificant industries are not taken seriously compared to well financed and well organized groups like the animal rights activist. Their membership rosters and political contributions are public record. Correspondingly, they are taken far more seriously than an industry that is seriously under represented insofar as public records are concerned.

The argument, of course, is that the bird industry is composed of hobbyists. Obviously there is some truth to this. However, each of us in the bird industry knows some, perhaps many, individuals who have developed quarter of a million to million dollar collections of birds. This was hardly accomplished through a "hobby". I personally know individuals who have purchased cars for cash and paid off their loans on their houses early yet still consider their aviculture enterprises as nontaxable hobby income.

Most aviculturists have little understanding of the tax laws and general business matters compared to the typical businessman. The frequent complaint, at least at the AFA convention in Salt Lake City, was an aviculturist couldn't make any money breeding birds. This is both true and false depending on your perspective. From the perspective of the typical aviculturist who trades offspring for more birds, or sells birds and turns around and purchases additional birds, there is a great deal of validity that their non-bird disposable income hasn't increased. The typical aviculturist typically just buys more birds with their money and has no extra spending money.

However, from an economic sense (or, more importantly, from an IRS perspective), there is a significant increase in wealth. An aviculturist

goes from a few birds to many birds over a relatively short period of time (let's say 10 years). This increase in wealth, i.e. more birds, is a taxable event. Internal Revenue Code section 61(a) says in part, "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived...". The subtitle is the Internal Revenue Code. Congress has taken a very inclusive view that includes bartering, selling then rebuying, trading birds, eggs or any other source of bird related income. From all the tax education associated with my Master's degree, and in over a decade of practicing tax, I have never read nor even heard rumors of an exception in the Internal Revenue Code related to the nontaxability of income associated with parrot breeding or, for that matter, hobby income.

In an editorial several months back, Jack Clinton-Eitniear made reference to an animal rights group that called on members to report breeders to the Internal Revenue Service. This is not an isolated event. This is the beginning of a new offensive against aviculturists. Unfortunately, this is far easier to accomplish than most aviculturists suppose. One needs simply to go through the newspaper pulling phone numbers for breeder advertisements from the newspaper, then match the phone number to a name and address from a "criss cross" available at almost any public library. Even unlisted numbers can be found in such publications. Then it is just a matter of forwarding this information to the appropriate department of the Internal Revenue Service. *There is even a special form for doing this!*

If there is one thing I learned over the past half year battling the IRS in the largest parrot breeding tax case to come before the United States Tax Court, it is that we found the IRS very unsympathetic to aviculturists. We felt that the entire case was based upon an animal rights perspective. I seriously hope this is a local exception rather than a national rule.

In conjunction with this somewhat nebulous risk of animal rights activism is a more tangible threat. The Internal Revenue Service is beginning its third year of a program titled *Compliance 2000*. The Internal Revenue Service has devoted an unprecedented 1/7th of their national manpower budget to implementing this program. It was the

concern of the Internal Revenue Service that non-reporting and non-filing of taxes were on the increase. This program was implemented to deal with this problem. All non-filers (those who have not filed tax returns) are being personally contacted by revenue agents (degreed, highly trained professionals) with the Internal Revenue Service to ensure that they have filed their tax returns. If they do not, the Internal Revenue Service is authorized under IRC 6020(b) to file a return for them, usually calculating substantially more tax than would otherwise be required.

The second part of this national program has more applicability to aviculturists. It is the identification of cash oriented businesses that have low compliance. In other words, industries where large amounts of cash are traded yet appropriate documents are not filed. Aviculturists are in the process of being caught up in this web due to the extensive publicity related to the ostrich and emu industry. I understand from sources inside the Internal Revenue Service that this industry is being analyzed as this article goes to press. The IRS is reviewing tax returns of prominent ratite breeders whose names are found in newspaper stories, in addition to those listed in classified advertisements and auction house records, to ensure that the large profits being made in this industry are being reported. The IRS is also contacting various check cashing businesses and comparing the results against reported income. This does not bode well for aviculturists as there is a distinct overlap between those owning ratites and those owning hookbills and various other assorted birds.

Within the Internal Revenue Service there has been a distinct shift in emphasis. Promotions, favorable personnel evaluations, and pay raises are going to those individuals who "enhance revenue" through taxpayer fraud programs. I know of an individual who was promoted to an appeals officer position (a very favorable posting) on finding low compliance among umpires! There are tremendous forces coming to bear upon our industry that makes massive Internal Revenue Service review inevitable.

In September of 1993, I sat as an interested spectator through a two week trial involving a parrot smug-

gling case. In testimony, it was established that, during the raid of the defendant's property which netted 70 Amazon chicks, there was an agent from the IRS Fraud Unit among the many officers participating in the raid from Customs and Fish and Wildlife. *All* financial records were seized. The evidence submitted in the trial indicated that there had been no tax returns filed for the parrot business. Further, it was shown the defendant also had accumulated a state-of-the-art aviary, incubators and had hundreds of pairs of birds on his property. The prosecution could not prove the smuggling case and the trial ended in a hung jury. However, the defense clearly established the defendant's ability to breed, incubate and raise numerous baby parrots. Numerous transactions were in the thousands of dollars range and many were in excess of ten thousand dollars. As possession of these financial records were in the hands of the Internal Revenue Service, it is a safe assumption that those transactions involving cash (which was practically all of them) will be closely scrutinized by the IRS. This breeder did business throughout the country, especially on the east coast.

This one raid, regardless of its final adjudication regarding the smuggling indictment, will spread out to show huge amounts of cash revenue trading hands and, of course, presumably unreported. In addition, there are reports of large breeding and importing operations already having been contacted by the IRS. The time has come for aviculturists to get their houses (or aviaries) in order. The consequences are severe.

In an audit of a typical aviary where there is a suspected unreported income problem, an IRS agent will simply count the number of breeding pairs and multiply a market value times four babies a year. A simplistic approach to be sure. Unfortunately, the burden of proof is on you to prove his calculation is incorrect. This is extremely difficult if you haven't been keeping records because you wanted your aviary under the table so to speak.

In addition to all the implications of HR 5013, it should be clear that keeping detailed breeding records for your operation is also crucial for tax reporting purposes whether you have

income or not. All expenses should be kept, even if it is small paper cash receipts. Otherwise if there is no substantiation of expenses, even if you are truly a hobby, a typical IRS audit will only pick up the income and you won't have the substantiation for the expenses.

I am of the professional opinion that all avicultural activities should be reported. It's an important safeguard. If you do not wish to deduct your avicultural pursuits, then simply file a schedule listing revenue and expenses showing a net loss. Notate that this is considered a hobby and simply do not carry the net loss over to the front page of your tax return. Nothing could be simpler.

The alternative is, of course, to treat your breeding operation as a business and deduct the losses or report the gains. The recent tax bill passed will be very favorable for most aviculturists as it will increase to \$18,500.00 the amount of capital assets (i.e. breeding birds) used in a trade or business that can be deducted as opposed to being depreciated. Additionally, if you incorporate, you may get to sell your incorporated aviary at a later date and only recognize 50 percent of the gain. A more thorough analysis should be done by your tax professional.

For those of you with substantial unreported income problems, the IRS typically will not pursue you criminally or impose the 100 percent civil fraud penalty if you report the income yourself by amending your tax returns. If significant amounts of taxable income are involved, this should only be done under the supervision and consultation of a tax professional or an attorney.

Insofar as compliance remains low within the aviculture industry, the IRS should be viewed as a significant threat to its continuation. However, it is a problem that can be remedied rather easily with full compliance with tax laws. Aviculture can never be considered credibly when large segments of the industry are actively avoiding the tax laws. Full compliance in the industry will also reduce the smuggling problem as record keeping is a proven deterrent to smuggling. In addition, smuggling remains lucrative because no taxes are being paid on this money. Everyone loses, you, me and, most importantly, the very avian life we are dedicated to preserving. ●