



February 5, 2011

To The Board of Directors of
Quechua Benefit

Re: Donation Deduction for Breeding Rights

We have been asked to provide a description of the basic tax implications and issues related to the donation of alpaca breeding rights to Quechua Benefit and in particular how a donor's charitable deduction for breeding rights may be computed. We have compiled the following response for use by the Quechua Benefit organization and understand that it will be posted on the organization's website for review by its membership and others. The information we have provided is not suitable for use by any particular taxpayer and is not provided as tax advice to be relied upon by anyone. Each individual donation deduction should be evaluated by a tax professional selected by the taxpayer who can evaluate all of the taxpayer's facts and circumstances and render an opinion about the available donation deduction. We have assembled general guidelines on this subject describing the applicable tax rules as we interpret them.

Our conclusion is that there will likely be no tax benefit for taxpayers making a donation of breeding rights to Quechua Benefit if the breeding rights are resold by Quechua Benefit. We looked at this problem from several different angles. The approach with the most promise treated the donation as a contribution of personal property, but, as you will see below, this only solves part of the problem. Here are the details of our analysis broken down into the three types of donations that might apply.

1. **Use of property.** The donation of the right to use property is considered the donation of a partial interest in property which is not deductible.
2. **Services.** If the breeding was considered a "service," it would not be deductible as there is no deduction for the value of time or services you give to a charity.
3. **Donation of personal property.** Because the alpaca breeding activity takes the place of artificial insemination used in other farm animal industries and because, in this context, animal semen does appear to be treated as personal property from a legal perspective, we feel there is a good argument to make that the breeding donation is correctly viewed as the donation of personal property. Once we cross this threshold, however, there is still the question of how the donation amount would be measured. Under the charitable deduction rules that apply to the donation of property for resale by a charity, the value of the donated property generally needs to be reduced by the amount of both capital gain and ordinary income that would be recognized if the breeding rights were sold for fair market value. Typically 100% of the income

from breeding rights is reported on the farmer's tax return as ordinary income with no offsets for costs that are directly associated with the breeding. This results in the amount donated being reduced to zero under the above computation.

Under the approaches described in paragraphs 2 and 3 above, the breeding rights donation deduction is disallowed because you are not permitted to deduct an item (services, value of time, property) if you have not previously recognized the item (or its appreciated value) as taxable income or purchased the item yourself. If you try to plan around this limiting concept by structuring the breeding rights donation in a way that requires income from the breeding be first recognized by the breeder and a cash donation is then made, we still end up with no net tax benefit because the breeder would show on their return an amount as income for the breeding that equaled the donation. This might actually create a higher net tax amount for the breeder because the breeding income can result in net farm income subject to self-employment tax. Income subject to the self-employment tax is not reduced by charitable donations. The higher farm income may also impact other tax computations that do not take into account charitable deductions.

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