

***This section contains the charts and graphs for the audio book.***

***It is suggested that you print this section and follow along while listening to the audio book.***

## **About Equinomics 101**

**Equinomics 101** is an equine financial management primer and software package. Far more than another tax manual, *Equinomics 101* brings a plain English approach to basic accounting, bookkeeping, and business management practice for horse business beginners and veterans alike.

## **About the Author**

Richard B. Dicks is a Certified Public Accountant and author of *Equinomics 101*. Richard has a strong personal connection to the equine business as a successful small breeder and investor. An established author and lecturer on equine financial, investment and tax issues, Richard has conducted seminars and workshops throughout the United States and in Europe. His common sense financial and investment approach to the horse business offers both the old hand and new investor the best opportunities for successful financial management of their horse ventures, regardless of the size of operation or breed of horse in which the horseman is involved.

Richard has represented horse industry clients from many breeds in tax audits and related matters throughout the United States, acting as an expert witness for federal tax court cases. A 1969 graduate of Oklahoma State University in Stillwater, Oklahoma with a B.S. in Accounting, Richard brings a lifetime commitment to the horse business and to agribusiness in general.

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## ~~ Section II ~~

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**CHART OF USE - DEBITS AND CREDITS**

|                        | DEBIT | CREDIT |
|------------------------|-------|--------|
| Increase Asset         | X     |        |
| Decrease Asset         |       | X      |
| Increase Liability     |       | X      |
| Decrease Liability     | X     |        |
| Increase Equity        |       | X      |
| Decrease Equity        | X     |        |
| Increase Revenue       |       | X      |
| Decrease Revenue       | X     |        |
| Increase Cost of Sales | X     |        |
| Decrease Cost of Sales |       | X      |
| Increase Expense       | X     |        |
| Decrease Expense       |       | X      |

As in the illustration below, an explanation of the *makeup* of the journal entry should follow each journal entry in the general ledger that records the results of a transaction (or group of transactions).

|                          | DEBIT      | CREDIT     |
|--------------------------|------------|------------|
| Breeding Expenses        | \$1,500.00 |            |
| Other Income - Hay Sales |            | \$1,500.00 |

*Entry to record the barter sale of hay in exchange for a breeding for the farm's mare to the stallion, Old Scudder.*

|                        | DEBIT       | CREDIT     |
|------------------------|-------------|------------|
| Horses                 | \$10,000.00 |            |
| Cash                   |             | \$5,000.00 |
| Notes Payable - Horses |             | \$5,000.00 |

**Equinomics 101**  
**Chapter 4 | Financial Statement Terms**

**BLACKIE'S MOWING**

**Balance Sheet**

December 31, 2008

|         |          |
|---------|----------|
| Cash    | \$0.00   |
| Tractor | 6,000.00 |

|              |            |
|--------------|------------|
| TOTAL ASSETS | \$6,000.00 |
|              | =====      |

**Liabilities**

|                             |            |
|-----------------------------|------------|
| Notes Payable - Spring Bank | \$4,000.00 |
|                             | =====      |

|                   |            |
|-------------------|------------|
| TOTAL LIABILITIES | \$4,000.00 |
|-------------------|------------|

**NET WORTH**

|                                |            |
|--------------------------------|------------|
| Net Worth, Beginning of Period | \$2,000.00 |
| Income for Period              | 0.00       |
| Net Worth, End of Period       | \$2,000.00 |
|                                | =====      |

|                                 |            |
|---------------------------------|------------|
| TOTAL LIABILITIES AND NET WORTH | \$6,000.00 |
|                                 | =====      |

**Night Moves Farm**

**Balance Sheet**

**December 31, 2008**

**Assets**

|                             |                       |
|-----------------------------|-----------------------|
| Cash                        | \$72,000.00           |
| Investments:                |                       |
| Big Stud Stallion Syndicate | 200,000.00            |
| Residence                   | 275,000.00            |
| Land - Farm                 | 325,000.00            |
| Horses                      | 350,000.00            |
| Trucks and Farm Equipment   | 125,000.00            |
| Barns and Farm buildings    | 275,000.00            |
| Fencing                     | 11,000.00             |
| Other Assets                | 14,500.00             |
| <b>TOTAL ASSETS</b>         | <b>\$1,647,500.00</b> |

=====

**Liabilities**

|                                  |                     |
|----------------------------------|---------------------|
| Accounts Payable - Farm Vendors  | \$11,525.00         |
| Accounts Payable - Payroll Taxes | 3,550.00            |
| Big Stud Syndicate               | 85,000.00           |
| Mortgage Payable - Residence     | 320,000.00          |
| Mortgage Payable - Farm          | 251,000.00          |
| <b>TOTAL LIABILITIES</b>         | <b>\$671,075.00</b> |

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**Net Worth**

|                                        |                       |
|----------------------------------------|-----------------------|
| Net Worth, Beginning of Period         | \$959,430.00          |
| Income for Period                      | 16,995.00             |
| Net Worth, End of Period               | \$976,425.00          |
| <b>TOTAL LIABILITIES AND NET WORTH</b> | <b>\$1,647,500.00</b> |

=====

**Night Moves, Inc.**  
**Statement of Income**  
**For the Year Ended, December 31, 2008**

|                                 | F.Y.E.<br><u>12/31/2008</u> |
|---------------------------------|-----------------------------|
| <b>REVENUES</b>                 |                             |
| LIVESTOCK SALES                 | 12,000.00                   |
| STUD FEES                       | 2,961.00                    |
| BOARD                           | 21,893.00                   |
| LESSONS                         | 40.00                       |
| COMMISSIONS                     | 2,700.00                    |
| OTHER MISCELLANEOUS             | <u>859.75</u>               |
| <b>TOTAL REVENUES</b>           | <b><u>40,453.75</u></b>     |
| <b>OPERATING EXPENSES</b>       |                             |
| SUPPLIES – FARM                 | 193.18                      |
| BEDDING                         | 820.00                      |
| HAY                             | 1,816.70                    |
| GRAIN                           | 3,542.60                    |
| FARRIER AND GROOMING            | 233.00                      |
| TACK                            | 150.00                      |
| INSURANCE                       | 434.00                      |
| CONTRACT LABOR                  | 6,507.55                    |
| EQUINE INSURANCE                | 15,000.00                   |
| VET AND MEDICINE                | 2,234.63                    |
| POSTAGE                         | 13.83                       |
| STUD AND NOMINATION FEES        | 278.00                      |
| ENTRY FEES                      | 1,775.00                    |
| OTHER SHOW EXPENSES             | 149.14                      |
| ADVERTISING                     | 437.61                      |
| PICTURES AND PROMO.             | 625.98                      |
| DUES AND SUBSCRIPTIONS          | 20.00                       |
| REPAIRS AND MAINTENANCE         | 655.84                      |
| RENTAL EXPENSES                 | 228.00                      |
| INTEREST EXPENSE                | 250.00                      |
| BULK FUEL, GASOLINE AND OIL     | 610.40                      |
| BANK SERVICE CHARGES            | 35.00                       |
| TRAVEL                          | 1,089.89                    |
| AUTOMOBILE EXPENSE              | 20.71                       |
| ENTERTAINMENT                   | 48.94                       |
| TELEPHONE                       | 323.30                      |
| UTILITIES                       | <u>1,101.38</u>             |
| <b>TOTAL GEN/ADMIN EXPENSES</b> | <b><u>38,594.68</u></b>     |
| <b>NET CASHFLOW</b>             | <b>16,995.34</b>            |

=====

Let's consider some of the possible account categories that might be included on your chart of accounts.

- 1-1000 Current Assets**
- 1-1100 Cash on Hand**
- 1-1110 Cash - Operating Account**
- 1-1150 Petty Cash**
- 1-1200 Accounts Receivable**
- 1-1300 Inventory**
- 1-2000 Other Assets**
- 1-2200 Notes Receivable**
- 1-3000 Fixed Assets**
- 1-3100 Agricultural Equipment**
- 1-3150 Acc Depr Agri Equip**
- 1-3200 Office Equipment**
- 1-3250 Acc Depr Off Equip**
- 1-3300 Vehicles**
- 1-3350 Acc Depr Vehicles**
- 1-3400 Farm Buildings**
- 1-3450 Acc Depr Farm Bldg**
- 1-3500 Horses Purchased**
- 1-3550 Acc Depr Horses**
- 1-3600 Land Improvements**
- 1-3650 Acc Depr Land Impr**
- 1-3900 Land**
- 1-4000 Deposits**
- 1-4100 Prepaid Insurance**
- 1-4200 Utility Deposits**
- 1-4500 Other Deposits**
- 1-5000 Other Assets**

XYZ HORSE FARM BANK RECONCILIATION - FIRST NATIONAL BANK

March 31, 2008

|                           |                       |          |          |                   |
|---------------------------|-----------------------|----------|----------|-------------------|
| <b>Balance Per Bank</b>   |                       |          |          | <b>\$1,535.00</b> |
| ADD - DEPOSITS IN TRANSIT |                       | DATE     | AMOUNT   |                   |
|                           |                       | 03/30/08 | \$750.00 |                   |
|                           |                       | 03/31/08 | \$250.00 |                   |
|                           |                       | 03/31/08 | \$125.00 |                   |
|                           |                       |          |          | \$1,125.00        |
| LESS - OUTSTANDING CHECKS |                       |          |          |                   |
|                           | CK #                  | DATE     | AMOUNT   |                   |
|                           | -                     | -        | -        |                   |
|                           | 945                   | 3/15/08  | \$345.00 |                   |
|                           | 948                   | 3/18/08  | \$23.00  |                   |
|                           | 950                   | 3/19/08  | \$56.00  |                   |
|                           |                       |          |          | (\$424.00)        |
| OTHER RECONCILING ITEMS   |                       |          |          |                   |
|                           | BANK CHARGES          |          |          | (\$15.75)         |
|                           | BANK DRAFT - NOTE PMT |          |          | (\$450.00)        |
| BALANCE PER BOOKS         |                       |          |          | \$1,770.25        |



Here's an example of the entry to record a receivable transaction. The farm's bookkeeper (you, in this case) has prepared a farm invoice for Mr. Bluster, a farm client. The invoice covers the purchase of one breeding in the amount of \$2,500.00 to the farm's herd sire, Old Scudder, for Mr. Bluster's mare, Miss Petite, and one month's board and mare care for her at \$400.00:

| <b>Account No</b> | <b>Description</b>  | <b>Debit</b> | <b>Credit</b> |
|-------------------|---------------------|--------------|---------------|
| 1-1200            | Accounts Receivable | \$2,900.00   |               |
| 4-1300            | Boarding & Training |              | \$400.00      |
| 4-1200            | Breeding Fees       |              | \$2,500.00    |

When Mr. Bluster pays the farm (hopefully within a few days), the entry for payment in full would be a debit to Cash Operating Account of \$2,900.00 and a credit to Accounts Receivable of \$2,900.00:

| <b>Account No</b> | <b>Description</b>       | <b>Debit</b> | <b>Credit</b> |
|-------------------|--------------------------|--------------|---------------|
| 1-1100            | Cash - Operating Account | \$2,900.00   |               |
| 1-1200            | Accounts Receivable      |              | \$2,900.00    |

But let's suppose that Mr. Bluster, being the below average deadbeat that he is, makes only a partial payment of \$1,000.00 against his account. This would result in the farm maintaining an Accounts Receivable balance from Mr. Bluster for the remaining \$1,900.00 balance due on his account. The entry for this transaction would look like this:

| <b>Account No</b> | <b>Description</b>       | <b>Debit</b> | <b>Credit</b> |
|-------------------|--------------------------|--------------|---------------|
| 1-1100            | Cash - Operating Account | \$1,000.00   |               |
| 1-1200            | Accounts Receivable      |              | \$1,000.00    |

In this example Miss Petite, a proven cross on Old Scudder in the past, is now 15 years old. The farm has decided to let her go while she still has several productive years ahead of her. In its mare band, the farm has retained two of her best daughters with which they can carry the farm's breeding program to the next level. Let us assume that the farm sells Miss Petite for \$25,000.00. The terms of the sale are 20% down (\$5,000.00), with the remainder to be paid in twenty-four (24) equal monthly payments of \$877.43 at an interest rate of 5% per annum.

The initial entry to record the sale would be as follows:

| <b>Account No</b> | <b>Description</b>       | <b>Debit</b> | <b>Credit</b> |
|-------------------|--------------------------|--------------|---------------|
| 1-1100            | Cash - Operating Account | \$5,000.00   |               |
| 1-2200            | Notes Receivable         | \$20,000.00  |               |
| 4-1100            | Livestock Sales          |              | \$25,000.00   |

Let us also assume that Miss Petite was originally purchased by the farm ten (10) years ago for the price of \$10,000.00, and that she has been fully depreciated on the books of the farm. The corresponding journal entry to record the removal of Miss Petite from the Fixed Assets of the farm and the related adjustment to Accumulated Depreciation would be as follows:

| <b>Account No</b> | <b>Description</b> | <b>Debit</b> | <b>Credit</b> |
|-------------------|--------------------|--------------|---------------|
| 1-3550            | Acc Depr Horses    | \$10,000.00  |               |
| 1-3500            | Horses Purchased   |              | \$10,000.00   |

This entry removes the value of Miss Petite from both the Horses account and from the Fixed Assets section of your Balance Sheet. At the same time, we must also remove the value of the prior depreciation expenses taken in prior years for the value of Miss Petite from the Accumulated Depreciation – Horses category.

## LOAN AMORTIZATION SCHEDULE

For Mr. Phineous T. Bluster Miss Petite

Prepared by Richard B. Dicks

LOAN AMOUNT: \$20,000.00

INTEREST RATE: 5.00%

TERM (MONTHS): 24

PAYMENT AMOUNT: \$877.43

|             | BEGINNING   |               |                   | ENDING             |
|-------------|-------------|---------------|-------------------|--------------------|
| Payment No. | BALANCE     | INTEREST      | PRINCIPAL         | BALANCE            |
| 1           | \$20,000.00 | \$83.33       | \$794.10          | \$19,205.90        |
| 2           | \$19,205.90 | \$80.02       | \$797.41          | \$18,408.49        |
| 3           | \$18,408.49 | \$76.70       | \$800.73          | \$17,607.76        |
| 4           | \$17,607.76 | \$73.37       | \$804.06          | \$16,803.70        |
| 5           | \$16,803.70 | \$70.02       | \$807.41          | \$15,996.29        |
| 6           | \$15,996.29 | \$66.65       | \$810.78          | \$15,185.51        |
| 7           | \$15,185.51 | \$63.27       | \$814.16          | \$14,371.35        |
| 8           | \$14,371.35 | \$59.88       | \$817.55          | \$13,553.80        |
| 9           | \$13,553.80 | \$56.47       | \$820.96          | \$12,732.84        |
| 10          | \$12,732.84 | \$53.05       | \$824.38          | \$11,908.46        |
| 11          | \$11,908.46 | \$49.62       | \$827.81          | \$11,080.65        |
| 12          | \$11,080.65 | \$46.17       | \$831.26          | \$10,249.39        |
| 13          | \$10,249.39 | \$42.71       | \$834.72          | \$ 9,414.67        |
| 14          | \$ 9,414.67 | \$39.23       | \$838.20          | \$ 8,576.47        |
| 15          | \$ 8,576.47 | \$35.74       | \$841.69          | \$ 7,734.78        |
| 16          | \$ 7,734.78 | \$32.23       | \$845.20          | \$ 6,889.58        |
| 17          | \$ 6,889.58 | \$28.71       | \$848.72          | \$ 6,040.86        |
| 18          | \$ 6,040.86 | \$25.17       | \$852.26          | \$ 5,188.60        |
| 19          | \$ 5,188.60 | \$21.62       | \$855.81          | \$ 4,332.79        |
| 20          | \$ 4,332.79 | \$18.05       | \$859.38          | \$ 3,473.41        |
| 21          | \$ 3,473.41 | \$14.47       | \$862.96          | \$ 2,610.45        |
| 22          | \$ 2,610.45 | \$10.88       | \$866.55          | \$ 1,743.90        |
| 23          | \$ 1,743.90 | \$ 7.27       | \$870.16          | \$ 873.74          |
| 24          | \$ 873.74   | \$ 3.64       | \$873.74          | \$ 0.00            |
|             |             | <b>TOTALS</b> | <b>\$1,058.27</b> | <b>\$20,000.00</b> |

This journal entry would record Mr. Bluster's fourth payment using the amortization schedule shown:

| <b>Account No</b> | <b>Description</b>       | <b>Debit</b> | <b>Credit</b> |
|-------------------|--------------------------|--------------|---------------|
| 1-1100            | Cash - Operating Account | \$877.43     |               |
| 4-5100            | Interest Income          |              | \$73.37       |
| 1-2200            | Notes Receivable         |              | \$804.06      |

You will notice that the only income recorded in this entry is for the interest income earned under the terms of the agreement. The actual income from the livestock sale was recorded at the time we recorded the terms of the contract for Miss Petite. (We'll look at this in greater detail when we do our case study later in the book.)

For example, on January 1st you might pay \$1,200.00 for one year of liability insurance. The Balance Sheet at the time of the transaction would show an asset, Prepaid Insurance expense, with a balance of \$1,200.00. If you looked at the Balance Sheet on March 31st, the balance for Prepaid Insurance expense on the Balance Sheet should be \$900.00 and the expense (Insurance Expense on the Statement of Income) should show a balance of \$300.00, reflecting the insurance expenses for three months at \$100.00 per month.

The entry to record the payment of Prepaid Insurance would be as follows:

| <b>Account No</b> | <b>Description</b>       | <b>Debit</b> | <b>Credit</b> |
|-------------------|--------------------------|--------------|---------------|
| 1-4100            | Prepaid Insurance        | \$1,200.00   |               |
| 1-1100            | Cash - Operating Account |              | \$1,200.00    |

The entry to charge off a portion of this prepaid liability insurance each month would be as follows:

| <b>Account No</b> | <b>Description</b>  | <b>Debit</b> | <b>Credit</b> |
|-------------------|---------------------|--------------|---------------|
| 6-1810            | Liability Insurance | \$100.00     |               |
| 1-4100            | Prepaid Insurance   |              | \$100.00      |

**Equinomics 101**  
**Chapter 5 | Depreciation and Accumulated Depreciation**

Now you may think that I have made an error or that this is a misprint, but on the contrary, this is not true. This is just another case of the government helping “simplify” the federal tax code. The reason that we have an extra year is the same reason that we use the Mid-Year Convention. We assume that all assets are placed in service on **July 1<sup>st</sup>** of the tax year, regardless of whether we purchased it or placed it in service on **January 1<sup>st</sup>** or **December 31<sup>st</sup>**. Therefore, we need that extra year to pick up that remaining half year of depreciation that we didn't use in Year One. Now that makes perfect sense, doesn't it? I knew you'd understand.

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**FARM PROPERTY DEPRECIATION TABLE USING MID-YEAR CONVENTION**

| Year  | 3-Year     | 5-Year                                                    | 7-Year                                | 10-Year                                      | 20-Year                                                     |
|-------|------------|-----------------------------------------------------------|---------------------------------------|----------------------------------------------|-------------------------------------------------------------|
|       | Racehorses | Autos, trucks,<br>most livestock,<br>other than<br>horses | Horses and<br>other farm<br>equipment | Single-purpose<br>agricultural<br>structures | All-purpose<br>machine sheds<br>and other farm<br>buildings |
| 1     | 25.00%     | 15.00%                                                    | 10.715%                               | 7.500%                                       | 3.750%                                                      |
| 2     | 37.50%     | 25.50%                                                    | 19.134%                               | 13.875%                                      | 7.219%                                                      |
| 3     | 25.00%     | 17.85%                                                    | 15.033%                               | 11.794%                                      | 6.677%                                                      |
| 4     | 12.50%     | 16.66%                                                    | 12.248%                               | 10.025%                                      | 6.177%                                                      |
| 5     |            | 16.66%                                                    | 12.248%                               | 8.739%                                       | 5.713%                                                      |
| 6     |            | 8.33%                                                     | 12.248%                               | 8.739%                                       | 5.285%                                                      |
| 7     |            |                                                           | 12.248%                               | 8.739%                                       | 4.888%                                                      |
| 8     |            |                                                           | 6.126%                                | 8.739%                                       | 4.522%                                                      |
| 9     |            |                                                           |                                       | 8.739%                                       | 4.462%                                                      |
| 10    |            |                                                           |                                       | 8.739%                                       | 4.461%                                                      |
| 11    |            |                                                           |                                       | 4.372%                                       | 4.462%                                                      |
| 12-20 |            |                                                           |                                       |                                              | 4.462%                                                      |
| 21    |            |                                                           |                                       |                                              | 2.231%                                                      |

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As stated above, allowable depreciation can commence when the asset, such as a horse, is placed into service. That may or may not be when the asset was originally purchased.

It is possible that an asset, especially a horse such as a foal, might be purchased in one year and not actually be placed into service as a viable income-producing asset of the horse farm until several years later. Remember also that horses that were bred by the farm, not purchased, cannot be depreciated. That's because the funds required to breed them, foal them out and raise them were all written off as they were expended.

## **DEPRECIATION TABLES FOR HORSES USING THE HALF-YEAR CONVENTION**

### **THREE YEAR TABLE**

Racehorses two years old or Other Horses over 12 years old when placed in service

| <u>Year</u> | Percent of <u>Original Cost</u> |
|-------------|---------------------------------|
| 1           | 25.00%                          |
| 2           | 37.50%                          |
| 3           | 25.00%                          |
| 4           | 12.50%                          |

### **SEVEN YEAR TABLE**

#### **All Horses not on Three Year Table**

| <u>Year</u> | Percent of <u>Original Cost</u> |
|-------------|---------------------------------|
| 1           | 10.71%                          |
| 2           | 19.13%                          |
| 3           | 15.03%                          |
| 4           | 12.25%                          |
| 5           | 12.25%                          |
| 6           | 12.25%                          |
| 7           | 12.25%                          |
| 8           | <u>06.13%</u>                   |
|             | 100.00%                         |

The Half-Year Convention is not allowed if more than forty percent (40%) of the cost of all property placed in service during a given year is placed in service during the last quarter of the year. If that is the case, then the Mid-Quarter Convention must be used. (You wouldn't want to take advantage of your government by taking those extra few months of depreciation in Year One, would you? I thought not.) The Mid-Quarter Convention *must* be used when over forty percent (40%) of the cost of assets placed into service during the year occurs during the last quarter of the year. Following is a set of tables to assist you if the Mid-Quarter Convention comes into effect in the depreciation of your farm assets. What I would really recommend is for you to go to your CPA or your tax advisor on this and have him either review your computations and assumptions or, better yet, prepare them for you. (The goal of this book is to help you better understand the various financial aspects of your horse operation, not to make you into a CPA. I wouldn't wish that on anyone.)

### Mid-Quarter Convention Table

#### 3-Year Farm Property

| Year | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
|------|-------------|-------------|-------------|-------------|
| 1    | 43.750%     | 31.250%     | 18.750%     | 6.250%      |
| 2    | 28.125%     | 34.375%     | 40.625%     | 46.875%     |
| 3    | 25.000%     | 25.000%     | 27.083%     | 31.250%     |
| 4    | 3.125%      | 9.375%      | 13.542%     | 15.625%     |

#### 5-Year Farm Property

| Year | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
|------|-------------|-------------|-------------|-------------|
| 1    | 26.250%     | 18.750%     | 11.250%     | 3.750%      |
| 2    | 22.125%     | 24.375%     | 26.625%     | 28.875%     |
| 3    | 16.250%     | 17.063%     | 18.638%     | 20.213%     |
| 4    | 16.520%     | 16.763%     | 16.567%     | 16.404%     |
| 5    | 16.520%     | 16.763%     | 16.566%     | 16.404%     |
| 6    | 2.065%      | 6.286%      | 10.354%     | 14.354%     |

#### 7-Year Farm Property

| Year | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
|------|-------------|-------------|-------------|-------------|
| 1    | 18.751%     | 13.394%     | 8.036%      | 2.679%      |
| 2    | 17.412%     | 18.560%     | 19.708%     | 20.856%     |
| 3    | 13.680%     | 14.582%     | 15.484%     | 16.386%     |
| 4    | 12.159%     | 12.220%     | 12.275%     | 12.182%     |
| 5    | 12.159%     | 12.220%     | 12.275%     | 12.182%     |
| 6    | 12.159%     | 12.220%     | 12.275%     | 12.182%     |
| 7    | 12.159%     | 12.220%     | 12.275%     | 12.182%     |
| 8    | 1.521%      | 4.584%      | 7.672%      | 10.658%     |

The following computation is necessary to determine what the amount of depreciation expense would be for tax purposes related to the barn and sheds during the first year of operation (starting in August):

$$3.75\% \times \$10,000.00 \times 5/12 = \$156.25$$

The entry to record depreciation on the books of the farm is a Debit (increase) to the Depreciation Expense account, which is reported on the Statement of Income and a Credit (increase) to the Accumulated Depreciation account, which is reported on the Balance Sheet.

The journal entry to record the depreciation of these buildings on to your farm books would be to debit Depreciation Expense and to credit Accumulated Depreciation Farm Buildings as shown below.

| <b>Account No</b> | <b>Description</b>   | <b>Debit</b> | <b>Credit</b> |
|-------------------|----------------------|--------------|---------------|
| 6-1300            | Depreciation Expense | \$156.25     |               |
| 1-3450            | Acc Depr Farm Bldg   |              | \$156.25      |



A list of potential liability accounts would include:

- 2-1000 Current Liabilities**
- 2-1100 Credit Cards**
- 2-1110 American Express**
- 2-1120 Mastercard**
- 2-1130 Visa**
- 2-1200 Accts Payable Trade**
- 2-1300 Sales Tax Payable**
- 2-1400 Payroll Withholding**
- 2-1410 Default Payroll Withheld**
- 2-1420 Fed Income Tax Payable**
- 2-1430 Fmed/Fsoc Payable**
- 2-1440 FUTA Payable**
- 2-1450 State Income Tax Payable**
- 2-1460 SU/SDI Payable**
- 2-1500 Accrued Employer Exp**
- 2-1700 Other Current Liab**
- 2-2000 Long Term Liab**
- 2-2100 Mortgages Payable**
- 2-2200 Bank Loans**
- 2-2300 Auto Loans**
- 2-2400 Horse Loans**
- 2-2500 Other L-T Liabilities**

For Corporations or Subchapter S Corporations, the following terms may come into play. (In a later section of the book, we will discuss the various business structures under which you may operate your farm business. Based upon your decision on what *structure* best fits your needs, you will be able to take advantage of the appropriate *accounts* that will best fit your needs.)

|               |                          |                                           |
|---------------|--------------------------|-------------------------------------------|
| <b>3-1000</b> | <b>Owner's Equity</b>    |                                           |
|               | <b>3-1100</b>            | <b>Owner's Investment - Capital Stock</b> |
|               | <b>3-1200</b>            | <b>Owner's Withdrawals</b>                |
|               | <b>3-1300</b>            | <b>Owner's Additional Paid In Capital</b> |
| <b>3-8000</b> | <b>Retained Earnings</b> |                                           |
| <b>3-9000</b> | <b>Current Year P/L</b>  |                                           |

**Equinomics 101**  
**Chapter 7 | Statement of Income**

Remember: **Total Revenues, less Cost of Sales (if applicable) and less Total Operating Expenses equal Net Income (or Loss) for operations.** Again, income is the result of any transaction that will in the end increase the farm's Net Worth.

Here's a listing of possible income account categories for your consideration:

- 4-1100 Livestock Sales**
- 4-1200 Breeding Fees**
- 4-1300 Board & Training**
- 4-1400 Commissions**
- 4-1500 Hay & Other Sales**
- 4-1600 Rental & Leasing**
- 4-1700 Racing & Showing**
- 4-1800 Rebillable Expenses**
- 4-1900 Miscellaneous**
- 4-2000 Govt Subsidies**
- 4-3000 Shipping & Collect**
- 4-5000 Misc Income**
- 4-5100 Interest Income**

Expense categories might include the following:

- 6-1100 Advertising**
  - 6-1110 Pictures & Videos**
- 6-1200 Breeding Fees**
  - 6-1210 Embryo Transfers**
  - 6-1220 Shipped Semen**
- 6-1300 Depreciation Exp**
- 6-1400 Registrations**
  - 6-1410 Futurities**
  - 6-1420 Nominations**
- 6-1500 Dues**
  - 6-1550 Subscriptions**
- 6-1600 Equipment Rental**
- 6-1650 Outside Board**
- 6-1660 Outside Training**
- 6-1670 Interest Expense**
  - 6-1671 Bank Service Charges**
- 6-1680 Horse Hauling**
- 6-1685 Other Freight**

- 6-1700 Supplies**
  - 6-1710 Feed**
  - 6-1720 Pesticides**
  - 6-1730 Seed**
  - 6-1740 Fertilizer & Chemicals**
  - 6-1750 Bedding**
  - 6-1760 Office Supplies**
  - 6-1770 Barn Supplies**
  - 6-1780 Small Tools & Tack**
  - 6-1790 Veterinary Supplies**
  - 6-1795 Other Supplies**
- 6-1800 Insurance**
  - 6-1810 Liability Insurance**
  - 6-1820 Equine Insurance**
  - 6-1830 Health Insurance**
  - 6-1840 Auto Insurance**
  - 6-1850 Other Insurance**
- 6-2000 Professional Fees**
  - 6-2010 Legal Fees**
  - 6-2020 Accounting Fees**
  - 6-2030 Consulting Fees**
  - 6-2050 Other Professional Fees**
  - 6-2060 Vet Fees**
- 6-2100 Licenses & Permits**
- 6-2200 Maintenance & Repairs**
  - 6-2210 Farm Repair**
  - 6-2220 Equipment Repair**
  - 6-2230 Trash Disposal**
  - 6-2250 Shavings Disposal**
- 6-2300 Delivery**
  - 6-2310 Postage**
  - 6-2320 FedX / UPS**
  - 6-2330 Other Freight**
- 6-2400 Rental Expenses**
- 6-2500 Showing Expenses**
  - 6-2510 Entry Fees**
  - 6-2550 Other Show Expenses**
- 6-2600 Racing Expenses**
  - 6-2610 Entry Fees**
  - 6-2650 Other Racing Expenses**

- 6-2700 Travel**
  - 6-2710 Lodging**
  - 6-2720 Transportation**
  - 6-2730 Rental Cars**
  - 6-2740 Travel Meals**
  - 6-2750 Entertainment**
- 6-2800 Storage**
- 6-3000 Property Taxes**
- 6-4000 Utilities**
  - 6-4100 Telephone**
  - 6-4150 Cell Phone**
  - 6-4200 Electricity**
  - 6-4300 Gas**
  - 6-4400 Water**
  - 6-4500 Computer Access**
- 6-5000 Payroll**
  - 6-5010 Wages**
  - 6-5020 Vacation Pay**
  - 6-5030 Employer Expenses**
  - 6-5040 Payroll Taxes**
  - 6-5050 Unemployment**
  - 6-5060 Contract Labor**
  - 6-5070 Housing – Farm Help**
- 6-5200 Fuel**
  - 6-5210 Bulk Fuel**
- 6-5900 Other Miscellaneous**
- 6-1700 Supplies**
  - 6-1710 Feed**
  - 6-1720 Pesticides**
  - 6-1730 Seed**
  - 6-1740 Fertilizer & Chemicals**
  - 6-1750 Bedding**
  - 6-1760 Office Supplies**
  - 6-1770 Barn Supplies**
  - 6-1780 Small Tools & Tack**
  - 6-1790 Veterinary Supplies**
  - 6-1795 Other Supplies**

As detailed below, actual payroll expenses are broken down into a number of items, most of which you are required to report to your friendly government authorities. Depending on the size of your operation, the best plan of attack may be for you to use the services of a competent payroll service or have your accountant handle your farm's reporting. Remember though, whether you use a service or handle it yourself, you are still the one that is responsible if this reporting is not properly filed.

**6-5000 Payroll**

**6-5010 Wages**

**6-5020 Vacation Pay**

**6-5030 Employer Expenses**

**6-5040 Payroll Taxes**

**6-5050 Unemployment**

**6-5060 Contract Labor**

**6-5070 Housing – Farm Help**

**Equinomics 101**  
**Chapter 10 | Barter and Like-Kind Exchange**

For example, if you traded a filly born and raised on your farm for a filly of like-kind from the farm down the road, that is a like-kind exchange. If you also received to boot, additional cash in the amount of \$1,000.00 and a load of hay worth \$500.00, then the transaction would be to record a credit to Income From Sales of \$1,500.00 (Cash of \$1,000.00 and Feed expense of \$500.00).

| <b>Account No</b> | <b>Description</b>     | <b>Debit</b>      | <b>Credit</b>     |
|-------------------|------------------------|-------------------|-------------------|
| <b>1-1100</b>     | <b>Cash on Hand</b>    | <b>\$1,000.00</b> |                   |
| <b>6-1710</b>     | <b>Feed</b>            | <b>\$500.00</b>   |                   |
| <b>4-1100</b>     | <b>Livestock Sales</b> |                   | <b>\$1,500.00</b> |

**Equinomics 101**  
**Chapter 11 | Deducting Equine Travel Expenses**

For travel on or after November 1, 2003, the IRS set the following per diem rates for lodging, meals and entertainment expenses in high-cost and low-cost localities:

|                           | <b>Lodging<br/>Expense Rates</b> | <b>Meals &amp;<br/>Entertainment<br/>Rates</b> | <b>Maximum per<br/>diem Rates</b> |
|---------------------------|----------------------------------|------------------------------------------------|-----------------------------------|
| <b>High-Cost Locality</b> | <b>\$161.00</b>                  | <b>\$46.00</b>                                 | <b>\$207.00</b>                   |
| <b>Low-Cost Locality</b>  | <b>\$90.00</b>                   | <b>\$36.00</b>                                 | <b>\$126.00</b>                   |

A taxpayer *must* substantiate expenditures for travel and entertainment by the maintenance of adequate records, or by sufficient evidence verifying,

- the actual cost,
- business purpose and
- the time and place of the travel.

**NIGHT MOVES FARM  
BUSINESS PLAN ASSUMPTIONS  
ONE- AND FIVE-YEAR PLANS  
2008**

**REVENUES:**

1. Sales - Horses: It is assumed that sales from Night Moves Farm should be in the range of \$20,000.00 for the year due to the auction in June. Sales should drop off in year two but then pick up in years three through five.
2. Board: Outside horses will be taken on a limited basis and should add an average of \$1,500.00 to \$2,000.00 per month to the operation.
3. Stud Fees: The farm projects only five outside mares to be bred to the farm stallion, Old Scudder, during year one and year two (\$1,000.00 stud fee). It is projected that this number will rise considerably once the quality of his foals is known in year three and thereafter.
4. Other Income: Additional income is expected from prize money, hay sales and other sources starting with \$500.00 in year one and rising substantially in year two and thereafter.

**EXPENDITURES:**

5. Feed and Supplies: It is assumed that feed, bedding and supplies in the amount of \$200.00 per month will be needed and will grow continually throughout the five years.
6. Farrier and Grooming: Farrier and grooming costs should run at around \$300.00 per month for the entire five years.
7. Show Expenses: This amount includes all expenses for the showing of Night Moves Farm's best show prospects. It will run \$1,500.00 for year one and increase to a level of approximately \$2,500.00 per year.
8. Insurance: Full mortality insurance is to be carried on the best farm stock. In addition, liability coverage is to be purchased for the protection of the farm's investment. The total cost of this coverage should run \$4,500.00 per year, growing to a high of \$5,000.00 per year.
9. Vet and Medicine: Vet charges for normal medical costs to keep the horses in good condition should run \$50.00 per month in year one and increase each year thereafter.
10. Advertising: A quarterly budget of \$250.00 will be maintained in years one and two. This will be increased in year three to \$300.00, up to a high of \$500.00 by year five.



11. Registration Fees: Registration fees will run \$100.00 per year based on maintaining a herd of four producing broodmares.

12. Hauling: Because the farm does not intend to invest in trucks and trailers, hauling costs should run at \$1,000.00 per year in years one and two and accelerate to \$2,000.00 after that time.

13. Mortgage Payments: The monthly mortgage payment is \$1,000.00 and the mortgage runs through year five.

14. Capital Expenditures: Additional capital expenditures of \$10,000.00 per year are planned to begin in year two. Nothing new is planned prior to that time.

15. Other Miscellaneous Expenses: It is assumed that there will be other costs in maintaining the horses, which are not covered by the items listed above. An additional budget of \$100.00 per month is budgeted to cover these costs in year one. This amount will increase yearly after that time.

**NIGHT MOVES FARM  
ONE-YEAR PLAN  
2008**

|                      | 1ST<br>QTR | 2ND<br>QTR | 3RD<br>QTR | 4TH<br>QTR | Total    |
|----------------------|------------|------------|------------|------------|----------|
| <b>Revenues:</b>     |            |            |            |            |          |
| Sales - Horses       | \$2,500    | \$10,000   | \$6,250    | \$1,250    | \$20,000 |
| Board                | \$6,000    | \$6,000    | \$6,000    | \$6,000    | \$24,000 |
| Stud Fees            | \$3,000    | \$2,000    |            |            | \$5,000  |
| Other Income         |            |            | \$500      |            | \$500    |
| Total Revenue        | \$11,500   | \$18,000   | \$12,750   | \$7,250    | \$49,500 |
| <b>Expenditures:</b> |            |            |            |            |          |
| Feed & Supplies      | \$600      | \$600      | \$600      | \$600      | \$2,400  |
| Farrier & Grooming   | \$900      | \$900      | \$900      | \$900      | \$3,600  |
| Show Expense         |            | \$500      | \$500      | \$500      | \$1,500  |
| Insurance            | \$4,500    |            |            |            | \$4,500  |
| Vet & Medicine       | \$150      | \$150      | \$150      | \$50       | \$500    |
| Advertising          | \$250      | \$250      | \$500      |            | \$1,000  |
| Registrations        |            | \$100      |            |            | \$100    |
| Hauling              | \$300      | \$300      | \$300      | \$100      | \$1,000  |
| Mortgage             | \$3,000    | \$3,000    | \$3,000    | \$3,000    | \$12,000 |
| Capital Expenditures |            |            |            |            | \$0      |
| Other Expenditures   | \$300      | \$300      | \$300      | \$300      | \$1,200  |
| Total Expenditures   | \$10,000   | \$6,100    | \$6,250    | \$5,450    | \$27,800 |
| Net Cash Flow        | \$1,500    | \$11,900   | \$6,500    | \$1,800    | \$21,700 |
| Cum Cash Flow        | \$1,500    | \$13,400   | \$19,900   | \$21,700   |          |

**NIGHT MOVES FARM  
FIVE-YEAR PLAN  
2008 - 2012**

|                      | Year<br>1 | Year<br>2 | Year<br>3 | Year<br>4 | Year<br>5 |
|----------------------|-----------|-----------|-----------|-----------|-----------|
| <b>Revenues:</b>     |           |           |           |           |           |
| Sales - Horses       | \$20,000  | \$10,000  | \$30,000  | \$40,000  | \$30,000  |
| Board                | \$24,000  | \$18,000  | \$20,000  | \$24,000  | \$20,000  |
| Stud Fees            | \$5,000   | \$5,000   | \$15,000  | \$20,000  | \$25,000  |
| Other Income         | \$500     | \$1,200   | \$2,400   | \$3,600   | \$3,600   |
| Total Revenue        | \$49,500  | \$34,200  | \$67,400  | \$87,600  | \$98,600  |
| <b>Expenditures:</b> |           |           |           |           |           |
| Feed & Supplies      | \$2,400   | \$3,000   | \$3,200   | \$3,600   | \$4,000   |
| Farrier & Grooming   | \$3,600   | \$3,600   | \$3,600   | \$3,600   | \$3,600   |
| Show Expense         | \$1,500   | \$2,000   | \$2,000   | \$2,500   | \$2,500   |
| Insurance            | \$4,500   | \$4,500   | \$4,500   | \$5,000   | \$5,000   |
| Vet & Medicine       | \$500     | \$1,200   | \$1,500   | \$2,000   | \$2,500   |
| Advertising          | \$1,000   | \$1,000   | \$3,600   | \$4,500   | \$6,000   |
| Registrations        | \$100     | \$100     | \$100     | \$100     | \$100     |
| Hauling              | \$1,000   | \$1,000   | \$2,000   | \$2,000   | \$2,000   |
| Mortgage             | \$12,000  | \$12,000  | \$12,000  | \$12,000  | \$12,000  |
| Capital Expenditures | \$0       | \$10,000  | \$10,000  | \$10,000  | \$10,000  |
| Other Expenditures   | \$1,200   | \$1,200   | \$2,400   | \$3,600   | \$4,800   |
| Total Expenditures   | \$27,800  | \$39,600  | \$44,900  | \$48,900  | \$52,500  |
| Net Cash Flow        | \$21,700  | (\$5,400) | \$22,500  | \$38,700  | \$26,100  |
| Cum Cash Flow        | \$21,700  | \$16,300  | \$38,800  | \$77,500  | \$103,600 |

**NIGHT MOVES FARM  
BUDGET VARIANCE REPORT  
FOURTH QUARTER**

|                           | 4TH<br>QTR<br>Actual | 4TH<br>QTR<br>Budget | QTR<br>Variance  | Y-T-D<br>Actual | Y-T-D<br>Budget | Y-T-D<br>Variance |
|---------------------------|----------------------|----------------------|------------------|-----------------|-----------------|-------------------|
| <b>Revenues:</b>          |                      |                      |                  |                 |                 |                   |
| Sales - Horses            | \$2,000              | \$1,250              | \$750            | \$18,300        | \$20,000        | (\$1,700)         |
| Board                     | \$5,900              | \$6,000              | (\$100)          | \$22,400        | \$24,000        | (\$1,600)         |
| Stud Fees                 | \$0                  | \$0                  | \$0              | \$5,000         | \$5,000         | \$0               |
| Other Income              | \$1,500              | \$0                  | \$1,500          | \$3,200         | \$500           | \$2,700           |
| <b>Total Revenue</b>      | <b>\$9,400</b>       | <b>\$7,250</b>       | <b>\$2,150</b>   | <b>\$48,900</b> | <b>\$49,500</b> | <b>(\$600)</b>    |
| <b>Expenditures:</b>      |                      |                      |                  |                 |                 |                   |
| Feed & Supplies           | \$400                | \$600                | \$200            | \$3,100         | \$2,400         | (\$700)           |
| Farrier & Grooming        | \$950                | \$900                | (\$50)           | \$3,600         | \$3,600         | \$0               |
| Show Expense              | \$1,000              | \$500                | (\$500)          | \$1,900         | \$1,500         | (\$400)           |
| Insurance                 | \$0                  | \$0                  | \$0              | \$4,500         | \$4,500         | \$0               |
| Vet & Medicine            | \$200                | \$50                 | (\$150)          | \$1,000         | \$500           | (\$500)           |
| Advertising               | \$0                  | \$0                  | \$0              | \$600           | \$1,000         | \$400             |
| Registrations             | \$0                  | \$0                  | \$0              | \$75            | \$100           | \$25              |
| Hauling                   | \$25                 | \$100                | \$75             | \$1,200         | \$1,000         | (\$200)           |
| Mortgage                  | \$3,000              | \$3,000              | \$0              | \$12,000        | \$12,000        | \$0               |
| Capital Expenditures      | \$3,200              | \$0                  | (\$3,200)        | \$3,200         | \$0             | (\$3,200)         |
| Other Expenditures        | \$150                | \$300                | \$150            | \$800           | \$1,200         | \$400             |
| <b>Total Expenditures</b> | <b>\$8,925</b>       | <b>\$5,450</b>       | <b>(\$3,475)</b> | <b>\$31,975</b> | <b>\$27,800</b> | <b>(\$4,175)</b>  |
| <b>Net Cash Flow</b>      | <b>\$475</b>         | <b>\$1,800</b>       | <b>(\$1,325)</b> | <b>\$16,925</b> | <b>\$21,700</b> | <b>(\$4,775)</b>  |

**NIGHT MOVES FARM**  
**SIX-WEEK ROLLING CASH FLOW REPORT**  
**JANUARY 6 - FEBRUARY 11**

|                      | 1ST<br>Week | 2ND<br>Week | 3RD<br>Week | 4TH<br>Week | 5TH<br>Week | 6TH<br>Week |
|----------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Sources:</b>      |             |             |             |             |             |             |
| Cash -               |             |             |             |             |             |             |
| Beginning Period     | \$1,000     | \$150       | \$600       | \$575       | \$875       | \$0         |
| Owner Contributions  | \$0         | \$0         | \$0         | \$400       | \$0         | \$0         |
| <b>Revenues:</b>     |             |             |             |             |             |             |
| Sales - Horses       | \$0         | \$0         | \$0         | \$0         | \$0         | \$0         |
| Board                | \$700       | \$0         | \$0         | \$0         | \$700       | \$0         |
| Stud Fees            | \$0         | \$0         | \$0         | \$1,000     | \$0         | \$1,000     |
| Commissions          | \$0         | \$750       | \$0         | \$0         | \$0         | \$0         |
| Other Income         | \$50        | \$50        | \$50        | \$50        | \$50        | \$50        |
| Total Revenue        | \$1,750     | \$950       | \$650       | \$2,025     | \$1,625     | \$1,050     |
| <b>Uses:</b>         |             |             |             |             |             |             |
| <b>Expenditures</b>  |             |             |             |             |             |             |
| Feed & Supplies      | \$600       | \$250       | \$0         | \$0         | \$600       | \$250       |
| Farrier & Grooming   | \$75        | \$0         | \$75        | \$0         | \$75        | \$0         |
| Show Expense         | \$0         | \$0         | \$0         | \$0         | \$0         | \$0         |
| Insurance            | \$0         | \$0         | \$0         | \$0         | \$0         | \$0         |
| Vet & Medicine       | \$325       | \$0         | \$0         | \$150       | \$0         | \$0         |
| Advertising          | \$500       | \$0         | \$0         | \$0         | \$500       | \$0         |
| Registrations        | \$0         | \$0         | \$0         | \$0         | \$0         | \$0         |
| Hauling              | \$100       | \$0         | \$0         | \$0         | \$0         | \$0         |
| Mortgage             | \$0         | \$0         | \$0         | \$1,000     | \$0         | \$0         |
| Capital Expenditures | \$0         | \$0         | \$0         | \$0         | \$0         | \$0         |
| Other Expenditures   | \$0         | \$100       | \$0         | \$0         | \$450       | \$0         |
| Total Expenditures   | \$1,600     | \$350       | \$75        | \$1,150     | \$1,625     | \$250       |
| Net Cash Flow        | \$150       | \$600       | \$575       | \$875       | \$0         | \$800       |

**BLACK ACRE FARM**  
**INVESTMENT ANALYSIS - MARE**  
**DISCOUNTED 8%**

|                        | Year<br>1      | Year<br>2       | Year<br>3       | Year<br>4       | Year<br>5       | Total            |
|------------------------|----------------|-----------------|-----------------|-----------------|-----------------|------------------|
| <b><u>Revenues</u></b> |                |                 |                 |                 |                 |                  |
| Sale of Mare           | \$0            | \$0             | \$0             | \$0             | \$50,000        | \$50,000         |
| Sale of Fillies        | 0              | 0               | 30,000          | 0               | 30,000          | 60,000           |
| Sale of Colts          | 0              | 0               | 0               | 2,500           | 2,500           | 5,000            |
| <b>Total Revenues</b>  | <b>\$0</b>     | <b>\$0</b>      | <b>\$30,000</b> | <b>\$2,500</b>  | <b>\$82,500</b> | <b>\$115,000</b> |
| <b><u>Expenses</u></b> |                |                 |                 |                 |                 |                  |
| <b>Board Expense</b>   |                |                 |                 |                 |                 |                  |
| <b><u>Mare</u></b>     | <b>\$3,000</b> | <b>\$3,000</b>  | <b>\$3,000</b>  | <b>\$3,000</b>  | <b>\$3,000</b>  | <b>\$15,000</b>  |
| Foal #1                | 1,500          | 3,000           | 1,500           | 0               | 0               | 6,000            |
| Foal #2                | 0              | 1,500           | 3,000           | 1,500           | \$0             | 6,000            |
| Foal #3                | 0              | 0               | 1,500           | 3,000           | 1,500           | 6,000            |
| Foal #4                | 0              | 0               | 0               | 1,500           | 3,000           | 4,500            |
| Stud Fees              | 2,500          | 2,500           | 2,500           | 2,500           | 0               | 10,000           |
| Commissions            | 0              | 0               | 4,500           | 375             | 12,375          | 17,250           |
| <b>Total Expenses</b>  | <b>\$7,000</b> | <b>\$10,000</b> | <b>\$16,000</b> | <b>\$11,875</b> | <b>\$19,875</b> | <b>\$64,750</b>  |
| Net Cash Flow          | (\$7,000)      | (\$10,000)      | \$14,000        | (\$9,375)       | \$62,625        | \$50,250         |
| Cum Cash Flow          | (\$7,000)      | (\$17,000)      | (\$3,000)       | (\$12,375)      | \$50,250        | \$0              |
| Pres Value @8%         | (\$7,000)      | (\$9,250)       | \$11,998        | (\$7,434)       | \$46,029        | \$34,343         |
| Disc Factors           | 1.0            | .925            | .857            | .793            | .735            | 0                |

The farm based the above assumptions on expectations for the mare to produce an estimated \$115,000.00 in revenues over the life of the investment. With expenses estimated to run slightly over \$64,750.00 during the projected period, it would appear that under the assumptions listed above, the farm could expect a return of approximately \$50,250.00 cash on their investment in this mare.

Discounted at the desired 8% rate of return, this would indicate that the maximum bid ceiling that the farm could expect to pay at the auction would be approximately \$34,350.00. If their estimates are well thought out, reasonable and conservative, the mare would be a good investment for that farm at any price up to this amount. If the bidding should go over this amount, the farm should pass on the purchase.

Business plans are only as good as the logic behind them, and the diligence to follow through on them.

Now let's take a look at some examples.

**BLACK ACRE FARM INVESTMENT ANALYSIS -  
SHOW HORSE DISCOUNTED 8%**

| <u>YEAR:</u>     | <u>1</u>         | <u>2</u>         | <u>3</u>        | <u>4</u>        | <u>Total</u>    |
|------------------|------------------|------------------|-----------------|-----------------|-----------------|
| <b>REVENUES:</b> |                  |                  |                 |                 |                 |
| Prize Money      | \$3,000          | \$15,000         | \$15,000        | \$2,500         | \$35,500        |
| Resale           | 0                | 0                | 0               | 30,000          | 30,000          |
| Total Rev        | <u>\$3,000</u>   | <u>\$15,000</u>  | <u>\$15,000</u> | <u>\$32,500</u> | <u>\$65,500</u> |
| <b>EXPENSES:</b> |                  |                  |                 |                 |                 |
| Training         | \$6,000          | \$6,000          | \$6,000         | \$3,000         | \$21,000        |
| Show Expenses    | 5,000            | 5,000            | 5,000           | 2,500           | 17,500          |
| Commissions      |                  |                  |                 | 4,500           | 4,500           |
| Total Exp        | <u>\$11,000</u>  | <u>\$11,000</u>  | <u>\$11,000</u> | <u>\$10,000</u> | <u>\$43,000</u> |
| Net Cash Flow    | (\$8,000)        | \$4,000          | \$4,000         | \$22,500        | \$22,500        |
| Cum Cash Flow    | <u>(\$8,000)</u> | <u>(\$4,000)</u> | <u>\$0</u>      | <u>\$22,500</u> | <u>\$0</u>      |
| Discounted 8%    | <u>(\$8,000)</u> | <u>\$3,700</u>   | <u>\$3,428</u>  | <u>\$17,843</u> | <u>\$16,971</u> |
|                  | =====            | =====            | =====           | =====           | =====           |

Under the same analysis theory that was used in determining the optimum purchase price for the mare above, the farm should probably not pay more than \$15,000.00 to \$17,000.00 for the purchase of this show horse prospect. It is possible in this instance, however, that the importance of having a competitive show horse in the ring for promotional purposes for the farm could outweigh the return-on-investment guidelines of the farm. The waiving of these guidelines, however, can become a habit. As such, it can be very dangerous to the long-term well-being of the operation.

Under a method commonly called the **General Presumption**, the horse business has been specifically allowed to retain the “Two of Seven Rule.” In connection with this topic, we should address the way the Two of Seven Rule actually works. The tax code states that **a horse activity is considered to be a business if it has a legitimate profit two out of seven years for those years during the seven-year period that fall after the second profit year.** It must also be remembered that if the profit years do not fall in the right sequence to fit the particular fact situation, the General Presumption will not apply for that period.

For example, if a taxpayer has five consecutive loss years and then two profit years, the loss years in that seven year sequence **are not** covered by the General Presumption. In this case a previous history of profits, even though they may not fall in the correct periods to fit the general presumption test, should be ample evidence on behalf of the taxpayer to show the continued profit motive with regard to the operation. To fully understand exactly how the Two of Seven Rule works, one must remember that we are working with an ever-moving target. A given profit year may not only be the second year of one seven year presumption period; it may also be the beginning of another. With each profit year we encompass a different period. See the illustration below:

L L L P L L P [L L L] L L L L P P [L] P [L L L L] L L P L L P [L]

In the illustration above each year is represented by a (P), if the business year was Profitable or an (L), if the business operated at a Loss. Only the bracketed loss years are covered by the General Presumption.