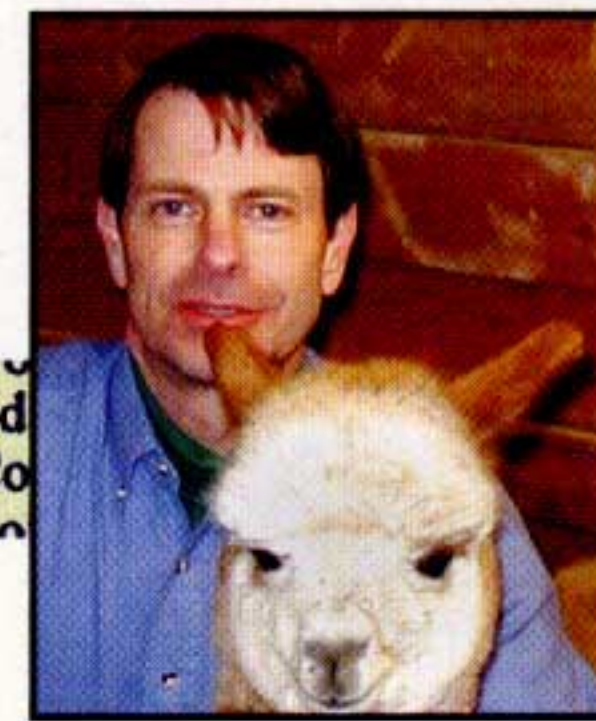


An understanding of the legal ramifications of contracts, agreements, and liabilities is integral to running your alpaca business. Alpaca breeder and attorney Daryl W. Goodrich helps to demystify these often complex legalities.



Daryl W. Goodrich, Esq.

Legal Lingo for the Layperson

Smooth Sailing Aboard the USS Alpaca

The Summer 2003 issue of *Alpacas Magazine* included at page 186 the results of the AOBA Auction 2003. The average selling price for a single alpaca was \$26,047. The average price for each of the four preceding annual auctions is also listed in the article. All are in the low \$20,000s. This is significant from a business-planning standpoint, especially since alpacas have been in this country now for 20 years.

I contend that alpacas are not a fad. They have many real uses that can involve the whole family. Alpacas are competitively shown at regional and national shows by children and adults alike. 4-H children train alpacas for agility and showmanship competition. Craft spinning and weaving opportunities abound for alpaca fiber.

In addition, alpacas enjoy a proven and strong commercial market for their fiber end products such as sweaters, hats, scarves, etc. Your alpacas' fiber can be sold into this market and family members can sell alpaca apparel and accessories.

The consistent selling price reveals the accuracy of my contention. More importantly, this consistent selling history and many uses demonstrate that the stable supply-demand relationship necessary for a profitable small business environment exists.

So the teddy bear, huggable look with those big dark eyes just makes you wish to have an alpaca. If it is to be a pet, go for it. If the alpaca business is in your sights, though, getting started

is more than just buying alpacas and a barn. One must also learn about running a business.

Running an alpaca business is like sailing on the ocean. There will be ups and downs – sometimes you will experience waves and swells; other times, it will be calm waters. On this imaginary “ocean cruise,” what would be your first step? Choosing a destination, of course. Drawing an analogy with the alpaca business, your “destination” is likely to be profits and increasing net worth. Always keep this in sight. It is too easy not to sell an alpaca because you have fallen in love with it. This reasoning is for pets not a business.

Before sailing you must select a boat, a map and navigation equipment. Just like safely cruising the ocean blue, successful businesses do not rely on luck but rather a firm foundation of the right tools.

Your boat is the structure that will carry you across the alpaca business ocean. It is the legal form or identity of your business. You can choose a small, nimble rowboat or a large yacht with all the bells and whistles.

What Size Ship?

A sole proprietorship is a one-man rowboat. It has the greatest freedom in structure and management and requires minimum start-up capital and costs. You are in complete control, but risk unlimited liability and lack of business continuity if, for whatever reason, you are no longer able to be at the helm.

The yacht is a corporation. It is highly structured and regulated and has centralized management and limited liability. It continues regardless of your personal involvement. It is also the most expensive and complicated vessel for your business. Personal liability for corporate debts is limited to the amount paid for the shares of stock. While a proprietorship is only available for a one-man business, one or more people can own a corporation.

Between these two extremes are partnerships and limited liability companies. They are the same in many ways, but have distinctly different legal consequences. Partnership partners have unlimited liability for business debts while LLC members' liability for business debts is limited to their investment. Both are easy to form and have low start-up costs and minimal outside regulation.

Partnership and LLC management structures and owner rights and obligations are set by owner agreement. This agreement should be in a detailed, signed contract. Partnerships and LLCs can have continuity of life after an owner ceases his involvement or dies – or not, depending on the terms of the organizing agreement.

Hire a Good Crew

Selecting a legal form for your business is best done with the advice of a lawyer. This selection is also heavily influenced by tax consequences and should be made with the additional

guidance of a financial advisor. Important tax issues to keep in mind are:

1. How will profits be taxed,
2. How can depreciation (accelerated and straight line) and early business losses be used to your tax advantage, and
3. How will the self-employment tax be applied to profits.

Profits from a corporate business will be taxed on the corporate level as well as on the individual level unless you elect to be an "S-Corporation." The "S-Corp" status enables you to avoid the double taxation of corporate profits. The other three forms of business are taxed only on the individual level. It can get complicated from a tax perspective, because the IRS may tax your business activities in a form different from the legal form you set up.

For example, if you do not operate your business in a businesslike manner, the IRS can treat your business as a hobby. Losses would then not be deductible. Also, if a partnership or LLC is organized and operated with corporate attributes, the IRS could tax them as a corporation subject to the characteristic double taxation. Another example is that LLCs are taxed as partnerships and they in turn can elect to be taxed as a corporation and then even to be treated as an S-Corp.

Accelerated depreciation and business losses, if brought through to your individual tax return, can shelter your non-farm earned income. These tax savings can then help you pay for alpacas. Certain fringe benefits, however, can only be deducted from profits if your business is taxed as a corporation.

Profits coming to your individual tax return via an S-Corp are taxed as investment income and not subject to self-employment tax. Tax treatment of proprietorships and partnerships brings profits to your individual tax return as earned income and thus is subject to self-employment tax.

I set up our alpaca farm as a limited liability company and generally prefer this form. Your individual circumstances, however, may dictate another form.

LLCs can have one or more members. They are formed by filing Articles of Organization with the appropriate state official. These Articles normally include the name and



principal office of the company, the name and address of the owners, and the name and address of the registered agent to accept on behalf of the company legal papers. While not required, I urge owners to also prepare and sign an Operating Agreement. It puts in writing their rights and obligations.

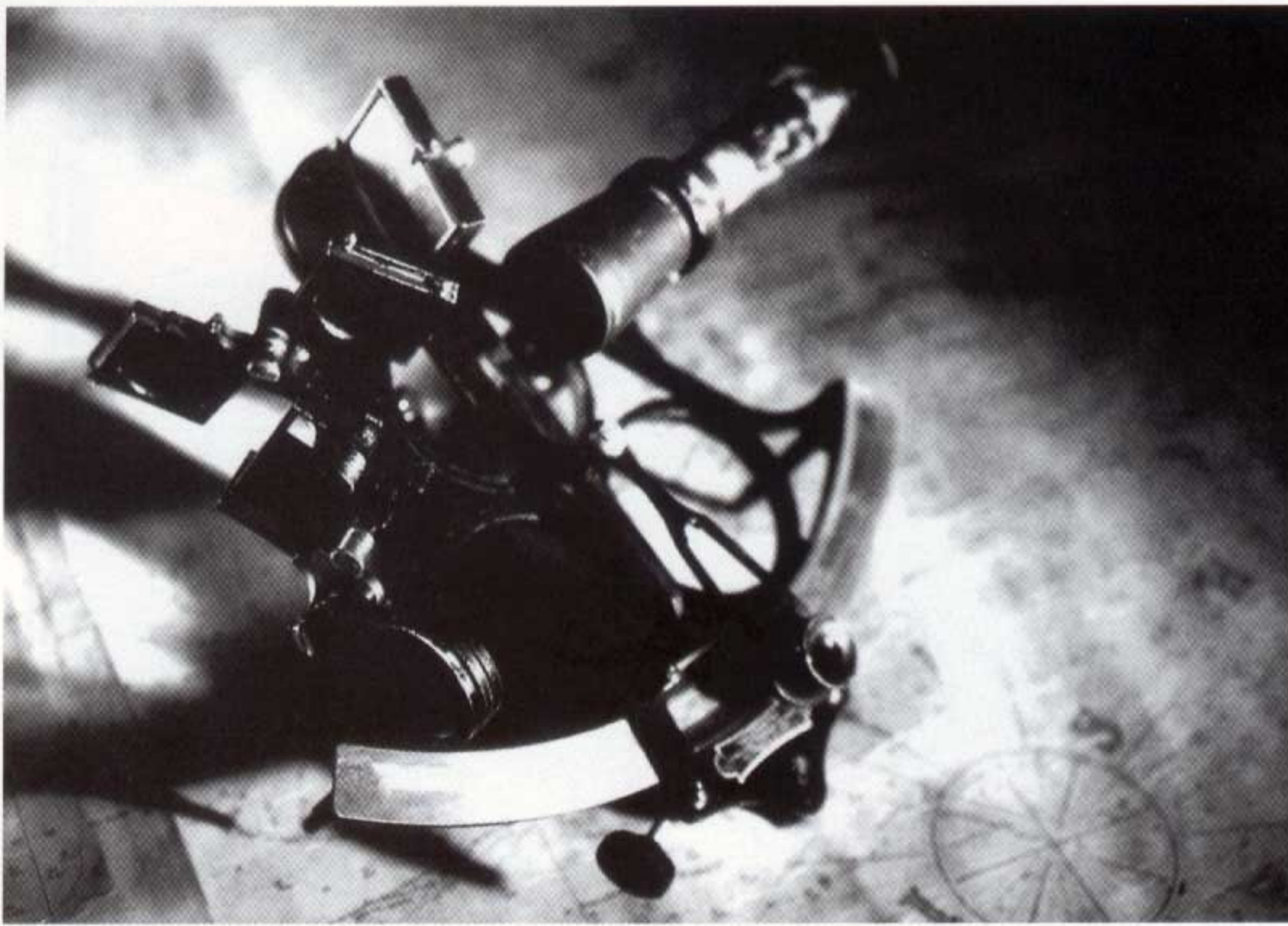
Specific issues are normally addressed in the Operating Agreement. Unless you are familiar with this process, a legal adviser should be consulted. Usually covered in Operating Agreements are:

1. business name, location, purpose,
2. members' authorities, duties, and restrictions,
3. initial and subsequent capital contributions,
4. draw against capital accounts and sharing of profits and losses,
5. members' salary,
6. voluntary/forced withdrawal of a member,
7. death/disability of a member,
8. sale of members' interest, and
9. dissolution of the business.

It is important to recognize that the LLC limited liability is not comprehensive. A member is personally liable for his negligent acts and omissions; personal guarantee of business loans and debts; and fraud and illegal acts. Members are also liable for business debts if the LLC business is operated as an extension of their personal affairs and for undeposited Federal taxes withheld from employees' wages.

Before untying your LLC's (or other business entity) moorings to set sail, you need a map showing the pathway to profits and increasing net worth. A business plan is that map. It describes your business and its goals and sets out a strategy to achieve those goals. When the winds of emotion and unexpected events blow you off course, the plan will redirect you toward the profit dock.

Get some books on writing business plans. Then do research. Visit alpaca farms and ask questions. The Alpaca Owners and Breeders Association has a library of helpful informa-



After setting sail, navigation equipment is necessary to tell where you are at any given point in time. Comparing this information with your map will tell if you are on course. Necessary adjustments can then be made to assure reaching your destination.

tion. A comprehensive business plan is very worthwhile. Your goals, ideas, preferences and research results should enable you to write a customary plan as outlined below.

Typically, business plans begin with a description of the proposed business (name, location, goals, products, services, financial needs, and uses of funds). Next, present the details of your alpaca farming process (barns, pastures, animal management and maintenance, suppliers, and how products and services such as alpaca apparel and boarding will be dealt with).

A market analysis highlighting competition, customers, trends and reasons for purchasing your products and services must also be included. Your advertising and marketing/sales strategy is an essential part as well. It will include pricing, promotion, sale terms/agreements, assumptions, and marketing/sales methods and overall strategy.

Then describe your legal form of business and its management and staffing needs detailing key skills and how your members and outside consultants will be used. Do not forget to also analyze your risks, including not only potential problems but also possible contingent plans to get around them.

Finally, a financial picture of your alpaca business must be included. It will present a several year projected profit and loss statement, balance sheet and cash flow analysis. It will also include your assumptions basing these projections and an analysis of what happens if the key numbers in these projections do not work out.

A profit and loss statement sets forth sales revenue minus expenses (such as costs of goods sold, loan interest, and operation/overhead costs) over a stated time period. A balance sheet details assets, liabilities, and the resulting business net worth at a stated point in time. A cash flow analysis presents the sources, timing, and amounts of cash inflow (cash on hand, sales revenue, loan proceeds and capital contributions, for example) and cash outflow (capital asset expenditures, loan payments, and payments for goods sold and operating/overhead expenses, for example).

The profit and loss statement states your profit goal destination. The balance sheet states your net worth goal destination and the cash flow analysis makes sure you have enough money at all times to keep the business going.

Don't Get Lost at Sea

After setting sail, navigation equipment is necessary to tell where you are at any given point in time. Comparing this information with your map will tell if you are on course. Necessary adjustments can then be made to assure reaching your destination.

Periodic profit and loss statements will tell where business profits are. Periodic balance sheets will tell where business net worth, assets, and liabilities are. Comparing these actual numbers with the corresponding projections in your business plan will disclose if your alpaca farm is progressing as expected toward your goals.

Measuring your fuel reserves periodically is also an essential navigation

tool. Cash is the fuel of business and when you run out of cash, you will stop. Regardless of good intentions, if your revenue stream at any point during the year is not fast enough to pay your bills as they come due, you are out of business.

Periodic analyses of current cash flow will show how well your farm generates cash to pay its debts. When these analyses are compared to the business plan cash flow projections, you will know if there is enough fuel to get to port.

As you and your alpacas cruise, comparing actual numbers with business plan projections keeps you on course and enables more realistic projections. Reassessing projections based on actual business results and periodically updating your plan for changes and new data make your plan even more valuable.

www.nolo.com is an interesting resource website I found for small business related books including how to set up an LLC and write a business plan. Libraries and bookstores should also be checked.

Daryl W Goodrich is a New Jersey attorney who spent many years as in-house counsel for Fortune 500 companies General Electric Company and Kidde, Inc. He is also on the Board of Directors of the Alpaca Fiber Cooperative of North America, Inc. Daryl and his family now own and manage Angel Wood Alpaca Farm, LLC in Hackensack, NJ. They strive to assist breeders in reaching their alpaca goals. Daryl can be reached via e-mail at daryl@angelwoodalpacas.com or by phone at (908) 852-7204.