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CPA'S HELP ALPACA FARMERS: THE LATEST BEAST BUBBLE
NEW TAX BREAKS ARE FUELING THE ALPACA MARKET

Callicoon, N.Y. – Here in the foothills of the Catskills, a herd of sheep-like creatures with long necks and giant eyes stride timidly around Bob Bruce's backyard.

Mr. Bruce had never heard of an alpaca until a few years ago. Now the 54-year-old Manhattan television stage manager tends to about 50 of them at his country home on the weekends. "They are living art," he says.

He is particularly reverential this time of year. These slender cousins of the llama don't give milk. In the U.S., people don't eat their meat. While their fleece is gaining popularity, farmers in the U.S. make little money on it. But these ruminants yield something even richer: steep tax cuts.

"What can't I write off?" Mr. Bruce says. "I write off food, water, fences, the guy who cuts the lawn." He even wrote off a new extension on his home where he will hold alpaca seminars.

Two decades after arriving from South America, alpacas have suddenly become the investment animal of choice by a subculture of doctors, lawyers, and other unlikely farmers lured in part by new tax breaks.

In May 2003, Congress passed the *Jobs and Growth Tax Relief Reconciliation Act* to spur the economy. Among other things, it allows small business owners to write off 100% of newly acquired assets in the first year, rather than depreciate them over several years. The maximum write-off for those assets quadrupled to \$125,000 in May of 2007 and rises with inflation.

The sweetened benefits apply to alpacas being raised for profit. That helps explain why the number of alpaca farmers has roughly doubled more than 4,200 since 2002, according to the Alpaca Owners and Breeders Association. With more than \$100,000 alpacas among them, the owners network at hundreds of auctions and shows around the country. While the average price of an alpaca is about \$20,000, and rises about 5% a year, some vaunted animals have sold for more than \$500,000 during the past two years.

GAINING POPULARITY

Before the new tax rule kicked in, the alpacas were already gaining popularity prodded by television ads touting the animals as a ticket out of the city rat-race. Unlike horses or cows, alpacas are relatively low maintenance, costing a modest \$300 a year apiece to keep. They don't take up much room either. Between two and eight animals can live in a 1-acre backyard. Many owners believe that alpaca fleece – used by Marc Jacobs and other big designers – will someday yield big profits.

The tax change kicked the trend into high gear. Several experts are spreading alpaca tax advice in books and online. "Tax law is certainly working to keep the alpaca industry growing!" according to an online article by Susan Post, an Iowa accountant who says she relies on alpaca farmers for 20% of her business. A free download of her book, "The Tax Impact of Investing in Alpacas," is available online.

Among the new alpaca farmers is Gregory Myers, 44, a software engineer in Camas, Washington. During the Internet boom, he was creamed by taxes on stock options he received working for an Internet company, WebTrends Inc. He says the alpacas now roaming his 5-acre yard not only cut his income tax but his property taxes as well, since he now calls his home a farm.

"Had I bought stocks and bonds, I would not have been able to write that off as expenditures," says Mr. Myers.

ALPACA PROPONENTS SAY THEY HAVE LEARNED FROM PREVIOUS BUSTS

Critics worry that alpaca fever will end badly, joining in other speculative bubbles in agriculture. Prices of llamas – used for trekking and guarding farm animals – collapsed in the early 1990's because too many were imported. *(Yet today, some suri llamas can fetch prices equal to or higher than the regular alpaca market! The importation of alpacas from South America to the U.S. closed in 1999.)* Ostrich mania melted when the meat failed to penetrate mainstream palates. *(It is important to realize that emus/ostriches can produce many, many eggs and thus produce lots of offspring every week which flooded their market; on the other hand, an alpaca has a year long gestation and only can produce one offspring per year maximum.)*

About 4,000 tons of alpaca fiber is produced world-wide every year. Much comes from Peru, which has three million alpacas and inexpensive labor. U.S. owners, unable to compete with that market, only make real money by selling the animals.

Mr. Myers built a mill for \$60,000, hoping to process enough fiber to fund his farm. But the mill went bust, sending Mr. Myers back to work at a software company to pay off the debt. "Alpaca fleece was not as profitable as I thought it would be," he sighs.

"It's a classic pyramid scheme," scoffs Richard Sexton, a professor of agricultural economics at the University of California, Davis, who co-authored a study entitled "Alpaca Lies." Alpacas, he says, shouldn't sell for more than a few hundred dollars.

Tell that to Jim Webb. The 56-year-old Virginia home builder last year plunked down \$750,000 on just half an alpaca named Legacy. "I may be the biggest idiot walking the face of the earth, or I may be enhancing blood-lines and increasing my own income", says Mr. Webb.

Alpaca proponents say that they have learned from previous busts and vow to protect the alpaca market. The industry's official registry a few years ago stopped including alpacas born outside the U.S., deterring imports. Registry officials say they are improving U.S. fiber. Mr. Sexton calls it a "futile attempt at protectionism".

A CINDERELLA STORY

Alpacas first came in the U.S. in 1984 from Chile when the U.S. lifted a ban. "For years, they were the forgotten stepchildren of llamas", says Bill Coburn, an Ohio farmer who imported a few that year. "It is a Cinderella story, really."

Many more arrived after barriers with Peru were removed in 1994. Mr. Coburn purchased an alpaca named Royal Fawn from the alpaca world's folk hero – Don Julio Berredá. With its fine fleece, Royal Fawn earned about \$3 million in stud fees, siring some 500 babies, known as cria, Mr. Coburn says. In late 2005, a Virginia electrical engineer named Ernest Kellogg bought Royal Fawn with another investor for \$600,000.

By then, the new tax rules had kicked in. "I had never stepped foot on a farm before, says Brion Smoker, a 55-year-old accountant, near Hershey, PA. Last year, he bought alpacas with a \$110,000 low cost loan backed by a Pennsylvania economic-development program. He says he has cut his taxable income by more than \$40,000! The write-off cannot exceed taxable income. The new law is set to expire at the end of 2009.