YES — YACHT EXECUTIVE SOLUTIONS

EQUINE ENTERPRISE ADVISORY & COMPLIANCE BRIEF

Prepared for: Prospective Owners, Equine Industry Professionals, and Tax & Legal Counsel

Subject: Structuring Equine Operations for Profit-Motive Compliance Under IRC §183

July 2026

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Executive Summary

Equine operations occupy an unusual position in the tax code. The Internal Revenue Service applies the hobby-loss rules of IRC §183 to horse activities more often than to almost any other category of business, and it does so under a statutory standard that differs from the one most advisors default to. At the same time, the code grants horse operations a longer runway to establish a profit motive than most other activities receive.

This is not a marginal concern. A 2016 audit by the Treasury Inspector General for Tax Administration found that 88 of 100 sampled Schedule C returns showed indications the business was not actually engaged in for profit.[1] When §183 profit-motive disputes are actually litigated, the pattern holds: across 265 reviewed decisions spanning the Tax Court, district courts, the Court of Claims, and the appellate courts, the IRS prevailed on the §183 issue roughly 75–80% of the time.[2] This is not a secret to the IRS, to the CPAs who sign these returns, or to the taxpayers who file them — the exposure is well understood industry-wide. What is usually missing is not awareness of the risk, but the structural, documented business framework that would actually hold up if examined.

This asymmetry — heightened scrutiny paired with an extended statutory presumption period — means outcomes for equine owners depend heavily on how the operation is documented and structured from the outset, not just on how it ultimately performs financially.

It is worth being precise about what YES actually delivers, because it is a meaningfully different proposition than documentation alone. Our objective is not simply to build a paper record sufficient to argue profit motive if examined — it is to structure the operation so that it produces a genuine, documented net after-tax profit. A business that can only survive an audit is still a fragile business; a business that is actually profitable satisfies the §1.183-2(b) factors as a natural consequence of being real, and it is a better outcome for the client regardless of whether the IRS ever looks at the return. Our compensation structure reflects this: we are paid on documented, realized savings, which means our economics depend on the client's operation actually working, not merely on paperwork that argues it does. This is also why our engagement capacity is deliberately limited — producing genuine profitability for a specific client's specific operation is a different, more demanding undertaking than producing standardized compliance documentation, and it does not scale the way a template does. It is also the reasoning behind describing this approach in terms of arbitrage rather than speculation: the goal is a structurally locked-in gain, not a directional bet on the operation eventually becoming profitable and hoping the documentation holds up in the meantime.

YES Yacht Executive Solutions is a consulting managerial economics practice. We are not a CPA firm, a law firm, or a registered investment advisor. We are not positioned, nor do we seek, to be a substitute for the client's existing advisory relationships. Our role is narrower and complementary: we work alongside the client's CPA and attorney to design the operational, documentary, and capital structures that support a defensible profit motive, and to identify structural opportunities specific to the client's complete financial picture — not the horse operation in isolation.

[1] Treasury Inspector General for Tax Administration, Report 2016-30-031, "Opportunities Exist to Identify and Examine Individual Taxpayers Who Deduct Potential Hobby Losses to Offset Other Income" (2016).

[2] Analysis of 265 litigated IRC §183 decisions (Tax Court, district court, appellate, and Court of Claims), reported by Peter J. Reilly, "Tax Advisers Are Too Afraid Of The Hobby Loss Rules," Forbes (May 29, 2019).

This alignment is deliberate, not incidental. A CPA or attorney whose client's equine operation is profitable and well-documented faces less audit exposure, less preparer-penalty risk under §6694, and a client relationship built on results rather than defense. An equine operation that fails is a worse outcome for the client, for their advisory team, and for everyone whose livelihood depends on that operation — the trainer, the barn, the veterinarian, the farrier. A profitable, properly structured operation is a better outcome for every party involved, including the client's existing advisors. That shared interest, not competition with the existing advisory team, is the premise this brief is built on.

This brief summarizes the statutory and regulatory framework we design around, the preparer-conduct standards that inform how documentation should be built, relevant case law illustrating how these factors are actually applied, and the private financing structure — the Stable Investment Model — that we make available to qualified clients.

1. The Statutory Framework: IRC §183

IRC §183 disallows deductions for activities “not engaged in for profit” beyond the income the activity generates. The statute provides a rebuttable presumption: if an activity shows a profit in a specified number of years within a testing period, it is presumed to be engaged in for profit, shifting the burden to the IRS to prove otherwise.

For most activities, that presumption requires a profit in 3 of the preceding 5 consecutive years. IRC §183(d) provides a distinct rule for activities that consist primarily of breeding, training, showing, or racing horses: the presumption applies if the activity shows a profit in 2 of the preceding 7 consecutive years.

> **The 7-Year Rule**
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> IRC §183(d): an equine activity consisting primarily of breeding, training, showing, or racing horses is presumed to be engaged in for profit if it shows a profit in 2 of 7 consecutive years, rather than the 3-of-5 standard that applies to most other activities.

Two points are frequently misunderstood about this provision. First, the presumption is rebuttable in both directions — meeting the 2-of-7 threshold creates a presumption of profit motive, but the IRS can still rebut it with contrary evidence, and failing to meet the threshold does not automatically mean the activity is a hobby. Second, and more consequential in practice: an election under §183(e) to defer the profit-motive determination until the testing period closes suspends the statute of limitations for those years. That trade-off — a longer runway in exchange for extended audit exposure — is a structural decision that should be made deliberately, with counsel, not by default.

2. The Regulatory Test: Treasury Regulation §1.183-2(b)

Whether or not the statutory presumption is met, the IRS and the Tax Court evaluate profit motive under Treasury Regulation §1.183-2(b), which sets out nine non-exclusive factors. No single factor is determinative; the analysis weighs the operation as a whole. These factors are the actual basis on which examining agents and courts decide equine hobby-loss cases, and they are the framework our documentation and operational recommendations are built around.

Factor	What the Regulation Looks At
Manner of operation	Whether the activity is carried on in a businesslike manner — books and records, separate bank accounts, a business plan.
Expertise	Whether the taxpayer or their advisors have the expertise needed to run the activity as a business, and whether that expertise is actually applied.
Time and effort	Time devoted to the activity, and whether the taxpayer withdraws from other substantial gainful employment to run it.
Appreciation expectation	Whether the taxpayer expects the horses or related assets to appreciate in value.
Prior success	Whether the taxpayer has succeeded in converting similar activities from unprofitable to profitable.
History of income or losses	The pattern of profits and losses, and whether losses are explainable as start-up costs or unusual events.
Amount of occasional profits	The amount of any profits earned, relative to losses and the taxpayer's investment.
Financial status	Whether the taxpayer has substantial income from other sources, which can (but does not automatically) suggest the activity is not profit-driven.
Elements of personal pleasure	Whether the activity involves elements of personal recreation, which weighs against profit motive but is not disqualifying on its own.

In practice, the first factor — manner of operation — is where most equine operations are won or lost, because it is the most controllable. A written business plan, separate books and accounting, a dedicated business bank account, documented marketing and sales efforts, and evidence that the operation adjusts its practices in response to results are all factors within the owner's control from day one. This is the area where we concentrate the majority of our structuring work.

3. How the Factors Play Out: Two Cases

The nine-factor test is easiest to understand in contrast. Two Tax Court decisions — one in the taxpayer's favor, one against — illustrate what actually separates a defensible equine operation from an indefensible one, and neither turns on whether the activity made money.

Engdahl v. Commissioner, 72 T.C. 659 (1979) — Losses every year, taxpayer wins

The Engdahls ran an American saddle-bred breeding operation that lost money in every one of the twelve years at issue. The Tax Court nonetheless held the activity was engaged in for profit. The taxpayers had consulted veterinarians, trainers, and breeders before starting; kept separate, complete books and a separate savings account for horse income; actively culled horses that didn't meet their breeding standards; and changed their practices over time to try to improve results. The court treated the losses as consistent with a long, well-documented start-up period rather than as evidence of a hobby.

Schumacher v. Commissioner, T.C. Memo. 2026-47 (2026) — Losses every year, taxpayer loses

The Schumachers ran a quarter-horse breeding operation that also lost money every year — for twenty-five consecutive years. The Tax Court held the activity was not engaged in for profit, pointing to incomplete books and records, the absence of a business plan, and the personal-pleasure element of the activity. The taxpayers did, however, avoid the accompanying 20% accuracy-related penalty, because they had specifically discussed §183 compliance with their accountant annually and documented that reliance — a separate protection under §6664 that does not depend on winning the underlying profit-motive issue.

> **The Distinction That Matters**
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> Both operations lost money every year. One was found to be a business; the other was not. The difference was documentation, businesslike operation, and demonstrated responsiveness to results — not profitability itself. Separately, the Schumachers' documented reliance on their accountant's specific advice protected them from penalties even where the underlying position did not prevail. Both outcomes reinforce the same point: the operational record is what the analysis turns on, and it is built well before any audit begins.

4. Preparer Conduct Standards and Documentation

Return preparer conduct is governed by IRC §6694 and Treasury Regulation §1.6694-2, along with the ethical rules in Treasury Department Circular 230. Under these standards, a preparer who takes a position on a return generally must have substantial authority for that position, or must disclose it, and must act in good faith with a reasonable basis. A preparer cannot rely on client representations they know or should know are incomplete or inconsistent.

What this means practically: any preparer signing returns that claim equine losses over consecutive years carries some exposure under these rules if the documentary record supporting profit motive is thin — independent of the client's own audit risk. Building the record contemplated by §1.183-2(b) is not a critique of the existing preparer's work; it is exactly the kind of documentation these standards contemplate the client's advisory team relying on. A well-documented operation gives the preparer a stronger, more defensible basis for the positions already being taken, and reduces exposure for everyone signing the return.

YES does not sign returns, render legal opinions, or manage investment assets, and we have no interest in inserting ourselves between a client and their existing advisors. What we provide is the operational documentation and business architecture — business plans, recordkeeping structure, entity design, and capital deployment records — that a client's CPA and attorney can review, rely on, and incorporate into their own analysis. The goal is a stronger position for the client's entire advisory team, not a replacement for any part of it.

5. Entity and Capital Structure

How an equine operation is held — sole proprietorship, single-member LLC, multi-member LLC, S-corporation, or a structure combining several entities across other business or real estate holdings — affects both the §1.183-2(b) analysis and the owner's broader tax and liability position. A properly capitalized, separately operated entity supports the “businesslike manner” factor directly; a horse purchased personally and expensed through an unrelated business does the opposite.

We review entity structure as part of a client's complete financial picture, including interaction with other business entities, real estate holdings, and state of domicile, and coordinate any changes with the client's attorney and CPA before implementation.

6. Capital Structure: The Stable Investment Model

Conventional lenders generally do not underwrite horses as loan collateral, which leaves buyers financing acquisitions with cash or not making them at all. For qualified clients, YES has arranged access to private, non-bank financing for equine acquisitions.

Term	Detail
Minimum down payment	10% of acquisition price, for qualified clients
Asset scope	Individual horses or full strings, across disciplines and breeds
Underwriting basis	The buyer's overall financial profile, not the horse as sole collateral
Trainer stability provision	Financed horses remain with the designated trainer of record; relocating the horse requires prior written approval, protecting both the lender's collateral position and the trainer's ongoing program revenue
Qualification	Available to active YES clients; financing and advisory work are engaged together, not separately
Availability	Select clients on a case-by-case basis, subject to underwriting approval — not a public lending program

Beyond enabling acquisitions that would otherwise require full cash payment, structured financing also supports the businesslike-operation factor under §1.183-2(b): a capitalized acquisition, serviced on a schedule and documented as such, is more consistent with commercial operation than an all-cash personal purchase.

7. State Relocation Planning — Florida & Texas

Owners relocating equine operations to Florida or Texas can access meaningful state-level advantages — including agricultural property tax exemptions and the absence of state income tax — but agricultural exemption qualification has its own state-specific standards, application deadlines, and ongoing use requirements that are independent of the federal §183 analysis. An operation can satisfy §183 and still fail to qualify for, or retroactively lose, an agricultural exemption if it is not structured to meet the state's requirements from the outset.

We coordinate federal profit-motive structuring with the state-specific requirements for agricultural classification in the client's new state of domicile.

8. Engagement Approach

Every engagement begins with a confidential review of the client's complete financial picture — not the equine operation in isolation. We work alongside the client's existing CPA, attorney, and financial advisors; we do not replace them, and any strategy we recommend is implemented in coordination with, and subject to the judgment of, the client's licensed advisors.

Fee arrangements for the tax and structural advisory engagement are available exclusively to clients who engage YES as their advisory relationship, and are negotiated individually for each client's specific situation — there is no fixed or standard fee schedule. In general, compensation is structured as a percentage of documented, realized tax savings, confirmed after implementation rather than projected in advance, but the specific percentage, timing, and structure of that arrangement — including whether it is measured in the first year, over multiple years, or on an ongoing basis — are set case by case and discussed directly with each client. The Stable Investment Model is a distinct arrangement with its own individually negotiated terms, but it is not offered on a standalone basis: it is available only to clients who have engaged YES for the tax and structural advisory relationship described herein. The two are structured and priced separately, but financing is not available independent of that advisory relationship.

We welcome direct contact from a client's CPA or attorney before, during, or after engagement. A profitable, properly documented equine operation is a better outcome for the client, for their advisory team, and for YES alike — that alignment of interest, rather than any conflict with it, is the basis on which we ask to be evaluated.

A closing note for the CPAs and attorneys reading this: the exposure described in this brief is rarely confined to a single client. If one of your clients has a horse operation carrying this risk, it's worth asking whether others in your book — anyone with a yacht, an aircraft, a ranch, or another lifestyle asset generating recurring losses — carry the same exposure under the same reasoning. Bringing those clients into a properly structured, documented framework isn't just better for them; it reduces your own audit and preparer-penalty exposure across your practice, not just this one file. A general discussion of how this analysis extends beyond horses is available at yes2yachting.com/irc-sec-183-hobby-loss-profit-solution.

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YES — Yacht Executive Solutions is not a licensed CPA firm, law firm, or registered investment advisor. Nothing in this document constitutes tax, legal, or investment advice. The statutory and regulatory provisions summarized here are general in nature; their application depends on each client's specific facts and circumstances. All strategies described should be reviewed and implemented in coordination with the client's own licensed CPA and attorney. The Stable Investment Model is available to select qualified clients only and is subject to YES underwriting approval..