



**Installment sale**

If an installment sale is used (Example 2), installments should be based on the value of the animals at the time of sale and should not be affected by subsequent changes in the size or value of the herd. If taxes are filed on the accrual accounting basis and breeding livestock is included in opening and closing inventories (rather than depreciated), all capital gain must be reported in the year of sale. Under cash accounting, the installment sale of breeding stock is subject to the same related party rules discussed under transferring machinery (*Information File Transferring Machinery*).

**Gradual sale**

Under a gradual sale, a portion of the breeding livestock is sold each year. The rate of transfer can be arranged to coincide with the normal culling cycle of the breeding animals, as shown in Example 3. When a mature animal is sold, the younger party supplies the replacements by buying them from an outside source, selecting them from her/his share of the

offspring, or purchasing them from the older party's herd. The older party keeps the income from the cull animals that are sold. For tax purposes, income is reported for each animal in the tax year that it is sold.

If the two parties farm together and income is divided according to the relative contribution of assets, the division of income should be recalculated each year as ownership of the breeding herd changes.

A gradual sale is probably not appropriate where a standard 50/50 livestock share lease is being used. In this case the younger party would want to acquire ownership of half the breeding livestock immediately.

**Lease**

If the younger party has limited capital, leasing part or all of the breeding livestock for a period of time may be preferable to purchasing them. Lease payments should be large enough to provide the owner (older party) a competitive return on investment and pay for insurance, death loss, and other ownership costs. For enterprises with frequent sales, such as dairy or farrowing pigs, payments can be set up on a monthly schedule to match the sale periods. Lease payments may have to be adjusted according to the number of female animals in the herd each month, if this number fluctuates significantly.

There are several ways the replacement of culled breeding animals can be handled when the herd is leased.

(1) The owner (older party) provides replacements from an outside source and receives all the income from selling cull animals (Example 4).

**Example 3. Breeding livestock gradual sale (purchased replacements).**

Value of herd:	\$45,000
Annual culling rate:	20%
Cows culled per year:	8/year
Sale value (\$625/cow):	\$ 5,000
Replacements supplied by buyer:	8/year
Cost of replacements (\$500/cow)	\$ 4,000

**Seller**

Capital gain: <sup>1</sup>	\$ 5,000/year
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**Buyer**

Depreciation in first-year:	
<i>non-family sale:</i> <sup>2</sup>	
-- expensing	\$ 4,000/ year
-- MACRS	0
<i>family sale:</i> <sup>3</sup>	
-- expensing	0
-- MACRS	\$600/year (4,000 x .15)

<sup>1</sup> Assumes cash basis taxpayer.

<sup>2</sup> Section 179 expensing.

<sup>3</sup> MACRS 150% declining balance method.

**Example 4. Breeding livestock lease (owner supplies replacements).**

Size of herd:	40 cows, 8 heifers
Value of herd:	\$45,000
Annual lease payment	\$ 9,000
Renter pays all operating costs.	

(2) Replacements are selected from the offspring of the herd. The owner (older party) either pays the tenant (younger party) for the replacements or credits their value against the rent due.

(3) The tenant (younger party) provides replacements from the offspring and gradually acquires ownership of the herd (Example 5). The tenant (younger party) pays rent on the remaining cows owned by the owner. Careful records should be kept of which animals are owned by each party.

The lease can continue indefinitely or a buy out can be arranged after a period of time has passed, or the younger party buys the herd gradually and leases the remainder. The lease payments decreases each year as ownership of the herd is transferred to the younger party.

**Gifting**

Breeding livestock also can be gifted, either gradually or all at once. The same tax treatment as for gifting machinery applies. Gifting also can be combined with a sale, gradual sale or leasing agreement.

**Other**

In situations where the younger party has little or no money to invest, he/she may receive a percent of the offspring in exchange for labor. The appropriate percent depends on the species of livestock, the costs involved and the type of facilities used (see *Information File Livestock Enterprise Budgets for Iowa*). In general, the share of offspring received each year should be equal to the percent of total production costs represented by the younger party’s labor.

**Example 5. Breeding livestock transfer under a lease, with gradual sale.**

Size of herd: 40 cows  
 Value of herd: \$40,000  
 Lease payment: 20% of value of owner’s herd  
 Culling rate: 20% annually

Renter supplies replacements, pays all operating costs.

<b>Year</b>	<b>Cows owned by owner</b>	<b>Value of cows</b>	<b>Lease Payment</b>	<b>Cows owned by tenant</b>	<b>Replacements supplied*</b>
Now	40	\$40,000	\$8,000	0	0
1	32	32,000	6,400	8	8
2	24	24,000	4,800	16	8
3	16	16,000	3,200	24	8
4	8	8,000	1,600	32	8
5	0	0	0	40	8

\* Replacements supplied at the beginning of each year.

**... and justice for all**

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