



payment should be based on the cost of owning the machine (depreciation, return on investment, insurance, and housing) and may run from 15 percent to 20 percent of the machine's value. A decision should be made on who pays for repairs and major overhauls.

### Breeding Livestock Transfer

The older party may sell a portion of the breeding herd (*Information File [Transferring Breeding Livestock](#)*) to the younger party. Installment sales reporting may be used, except if the buyer is a related party. Also a roll-over approach can be used with breeding livestock. The older party continues to own the breeding herd but the offspring are owned jointly with the younger party. When the original breeding animals are sold, the older party receives the income from the cull sale. Subsequently raised replacements are owned jointly.

### Grain and Market Livestock Transfer

An ownership interest in the grain and market livestock (*Information File [Transferring Crops and Market Livestock](#)*) can be sold or given to the young person. One approach is to transfer ownership at the low point of the feed inventory (just before harvest), or between the sale and subsequent replacement of market livestock. Another alternative is to transfer ownership over two tax years by making transfers at the end of one tax year and the beginning of the next tax year.

Instead of selling the young person an interest in the market livestock on hand, the livestock can be *inventoried*. When the livestock are subsequently sold, the original owner (older party) will receive the *inventory* value of the livestock with the remaining proceeds divided between both parties. Be careful that the use of the inventory concept does not change your "method of accounting" for income tax reporting purposes.

### Land Transfer

Land can be transferred during life by sale or gift, or at death. Often land is held by the older party until death, although a building site may be transferred earlier.

### Transfer by Sale

Land can be sold to the young person. The two major options are the cash sale and the installment sale, although other options such as the private annuity exist. A cash sale may not automatically reduce estate and inheritance tax liability because the sale proceeds may be taxed in the estate at the eventual death of the parents.

An installment sale can be used to spread the sale proceeds over several years with the original owner (older party) using the annual payments for living expenses. However, periods of inflation will reduce the real value of the fixed annual payments and, over a period of years, may substantially shrink the purchasing power of their income. Conversely, during a period of deflation the real value of the annual payments will increase, which may place a financial hardship on the buyer (younger party). Also, because the term of the contract is a fixed number of years, the seller (older party) may outlive the income stream.

### Transfer by Gift

Land can be given to the children. Each person (donor) can give up to \$14,000 (2016) of property each year to as many people as he/she would like, with no gift tax due (*Information File [Gift Tax](#)*) due. Together, a husband and wife can give \$28,000 each year, even though the property is owned by only one of them. A substantial amount of land can be transferred if there are several recipients. Remember, with a gift the parents give up ownership of the property. So if income from the property is needed to cover living expenses, or if the property is needed as security during retirement, a gift program should not be used.

### Transfer by Will

Land is often transferred at death according to the decedent's will. Transferring land at death allows the parents to use the property and receive income from it all through retirement. The major taxes assessed on property passing at death are the Federal Estate Tax (*Information File [Federal Estate Tax](#)*) and the Iowa Inheritance Tax (*Information File [Iowa Inheritance Tax](#)*). The Iowa Inheritance Tax is assessed on property passing to each heir.

There is no Iowa inheritance tax if transferred to a lineal descendent. Transfers at death may be eligible for *Special Use Valuation* and the *15-year Installment Payment of Federal Estate Tax*.

### ***Income Tax Considerations***

The method used to transfer land will greatly affect the income tax liability (*Information File [Income Tax Aspects of Property Transfers](#)*). This is especially true of land with a low income tax basis. If the land is transferred by sale, the seller (older party) pays income tax on the amount of gain between the tax basis and the sale value of the property, minus selling costs. The buyer (younger party) receives the property with a new basis equal to the purchase price. If the land is transferred by gift, the parents pay no income tax and the child takes over the parents' tax basis. If the property is passed at death, the parents pay no income tax on the gain and the child receives the property with a new tax basis equal to the federal estate tax value (usually the fair market value) in the estate. The gain on the difference between the original tax basis and the market value at death is not taxed. Obviously, there is often a substantial income tax advantage to transferring land and other property at death compared to transfers made during life.

### **Objectives of Transferring Ownership**

The method used to transfer ownership depends on the financial conditions and objectives of the parties involved. Typical asset transfer objectives include the following:

- **Ownership considerations** - The younger party needs to gain ownership of farm business assets over time.
- **Income tax considerations** - The income tax liability of the older party (seller) can be reduced by spreading the sale of the assets over a period of years or by using a gifting program. However, a gifting program reduces the tax advantages of the person receiving the asset. There are income tax advantages to both parties by holding until death assets that have appreciated in value.

- **Cash flow considerations** - The cash flow payments should match the income level of the younger party (the buyer). A purchase can be funded from current savings or financed by the older party (seller) or an outside lender. Spreading the sale or payments from the sale over a period of years can help the younger party meet the cash flow requirements with current income. If the younger party cannot afford to purchase the assets, a partial gifting program may be used.
- **Equity considerations** - All family members should be treated fairly. If a gifting program is used to transfer asset ownership to a son or daughter, the parents may want to consider making similar or equivalent gifts to non-farming children.

### **Business Transfer Strategies**

Business transfer strategies involve transferring the overall operation and management of the business. The method chosen for transferring machinery and livestock ownership often is based on the strategy developed for transferring the business. So a business transfer strategy must be developed before choosing a method for transferring ownership.

The planning horizon for transferring farm business assets from the older party to the younger party is an important consideration when developing an ownership transfer strategy. It usually corresponds to the length of time the parties intend to farm together. Fast strategies transfer the business from the older party to the younger party quickly or at one point in time. Gradual strategies transfer the business over a period of years and are used when the two parties plan to farm together for an extended period of time.

### ***Fast Business Transfer Strategies***

With fast transfer strategies, the two parties do not farm together. The older party leaves the business when the younger party enters the business. The younger party may acquire full ownership of the breeding and market livestock and crops at that time. A separate plan is developed to transfer machinery and equipment as quickly as possible.

Fast transfer methods include outright sale, installment sale, gift, part sale/part gift, and others. The younger party often cash rents land and facilities from the older party, and the two parties develop a separate plan to transfer these assets at a future time.

As an alternative, a livestock share or crop share lease may be developed so the younger party acquires only a half ownership share of the breeding and market livestock and crops. The parties develop a separate plan for transferring machinery and equipment.

### **Gradual Business Transfer Strategies**

With a gradual business transfer strategy, the two parties farm together for a period of years. The younger party may join the business and form a multi-person arrangement or the younger person may spin off and develop a separate business but still jointly own machinery and/or livestock with the older party. The transfer of machinery and breeding and market livestock occurs gradually over this period of time. Methods for accomplishing this include a gradual sale, lease with option to buy, gradual sale with lease, gradual sale with gift, and others.

**Multi-person firm** - With a multi-person firm, the younger party and the older party farm together for a period of time. The younger party usually buys a predetermined portion of the machinery and livestock, such as 50 percent. At the end of the transfer period, when the older party retires, the younger party buys the remaining share.

If the two parties farm together for only a few years, they may develop a flexible business arrangement, such as an operating agreement on one specific enterprise (*Information File*

[Enterprise Operating Agreement](#)) or the entire farm (*Information File* [Farm Business Operating Agreement](#)). If they farm together for many years, they may choose a more formal business arrangement, such as a partnership (*Information File* [Partnership](#)) or corporation (*Information File* [Corporation](#)). An important point to remember is that each time an asset is transferred, a change in the portion of the assets owned by each party occurs resulting in a change in how income is divided.

**Spin-off** - With a spin-off approach, the parties cooperate but farm separately. Instead of joining the older party, the younger party begins his/her own separate business on a separate land base. At least initially, they farm the two operations with one set of machinery that is owned by both parties. The two parties may co-own each piece of machinery, or each party may own separate machinery items.

The machinery may be owned in the same proportion as the land is farmed. For example, the older party may farm two-thirds of the total land base and own two-thirds of the machinery. This eliminates the need to make payments between the parties for machinery use. An arrangement may be developed where labor and machinery use (*Information File* [Labor and Machinery Sharing Agreement](#)) are traded between the businesses. With this arrangement, a method for compensating each other for machinery and labor is developed. As time passes, the parties may continue to share machinery and labor, or develop completely separate farming operations. When the older party retires, the younger party may purchase the machinery, or it may be sold to a third party.

---

### **. . . and justice for all**

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964.

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Cathann A. Kress, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.

---