

Transferring Crops and Market Livestock

Crops and market livestock are an important component of the process of transferring ownership from the older party to the younger party (AgDM File C4-13, The Farm Business Ownership Transfer Process, www.extension.iastate.edu/agdm/wholefarm/pdf/c4-13.pdf). When the younger party becomes part of an on-going farming operation, a transfer of current assets such as stored grain, feed, supplies, and market livestock often takes place.

If the younger party intends to farm with the older party for a period of years, he/she may purchase a partial interest (for example, 50 percent) in the crops and market livestock. The remaining portion will be transferred when the older party leaves the business. However, if the older party plans to leave the business when the younger party enters, a total transfer may occur at one point in time.

When the two parties farm together, they often own the market livestock, crops, feed, and supplies, in the same proportions. This may be in equal shares, such as in a livestock share lease or a 50/50 partnership. However, other proportions also are possible.

Time of Transfer

The capital outlays for the buyer (younger party) will be lowest if crops and market livestock ownership is transferred when their inventories are lowest. For crops this may be just before harvest. For livestock this may be just after a feedlot or finishing building has been emptied. Transferring

feeder animals when they are younger and have a low value per head also reduces cash requirements.

Delayed Payment

When transferring feeder livestock or feed inventories, the selling price may be established on one date, but the actual payment delayed until the livestock are sold. The cost of the livestock or feed can be considered a loan until it is deducted from the younger party's share of the sale proceeds. In the case of a dairy operation, payment for the purchase of a share of the feed inventory may be made in installments each time a milk check is received.

Establishing a Price

Assets such as grain, feed, supplies, and market livestock should be carefully inventoried, and their quantity and quality recorded. Value usually is determined from current local market prices. Example 1 shows a possible format.

Current price information can be obtained from websites, grain elevators, auction markets, market news services, and other sources. AgDM File C1-40, Suggested Closing Inventory Prices can be used for end of year transfers (www.extension.iastate.edu/agdm/wholefarm/pdf/c1-40.pdf). Prices should be adjusted for quality differences, especially for harvested forages such as hay or silage. Marketing costs such as transportation and handling also should be subtracted.

Example 1. Sale of crops and market livestock

Table with 6 columns: Description, Quantity, Weight, Price, Total value, Payment terms. Rows include Corn, Hay, and Yearlings with corresponding values.

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Feeder Livestock Transfer

Assets such as partially finished feeder livestock may not have a readily available market price. One alternative for estimating a price is to "proportion" the market proceeds according to the weight and value of the animal at the time it is transferred.

For example, assume the younger party purchases partially finished feeder pigs from the older party. The average weight of the pigs is determined at the time of transfer. When the market hogs are sold, the proceeds are allocated to each party in proportion to the amount of gain contributed by each party.

In Example 2, the added weight and added value for partially finished feeder pigs are calculated from the time the pigs are purchased by the younger party until they are sold as market hogs. Next, the proportion of the weight gain occurring before and after ownership transfer is determined.

Example 2. Estimating a value for partially finished feeder pigs

Purchase weight of feeder pigs	50 lb.
Weight at ownership transfer	100 lb.
Sale weight of finished pigs	250 lb.
Purchase cost	\$60 per head
Sale price	\$50 per cwt.
Sale value	\$125 (2.5 cwt. x \$50 per cwt.)
Increase in value (purchase price to sale price)	\$65 (\$125 - \$60)
Total weight gain	200 lb. (250 - 50)
Gain before transfer	50 lb. (100 - 50)
Percent gain before transfer	25% (50 lb. ÷ 200 lb.)
Gain after transfer	150 lb. (250 - 100)
Percent gain after transfer	75% (150 lb. ÷ 200 lb.)
Buyer's proceeds	\$48.75 (\$65 x 75%)
Seller's proceeds	\$76.25 (\$65 x 25%) + \$60)
Total proceeds	\$125 (\$48.75 x \$76.25)

These percentages determine how much of the added value (sale value minus purchase cost) should go to the younger party and how much to the older party. The amount going to the older party also includes the original purchase cost of the pigs.

This example assumes that the younger party purchases full ownership of the pigs. If the younger party buys only a half interest in the pigs, the same procedure is used, except only half of the proceeds generated after the ownership transfer go to the younger party (Example 3).

Example 3. Partial transfer of feeder pigs (50%)

Buyer's proceeds	\$24.37 (\$65 x 75% x .5)
Seller's proceeds	\$100.63 (\$65 x 25%) + (\$65 x 75% x .5) + \$60)
Total proceeds	\$125 (\$24.38 + \$100.63)

Income Tax Consequences

The sale of current, non-depreciable assets creates ordinary taxable income for the seller to the extent that the selling price exceeds the basis. For cash basis tax-payers, the basis of purchased property, such as feeder livestock or commercial feed, is the original purchase cost. For raised feed and livestock, the basis is zero. For accrual accounting taxpayers, the basis is the inventory value on the last tax return if the transferred items were owned then, or their purchase cost if they were not.

If the business is organized as a partnership or corporation, the younger party may simply purchase a percent ownership or number of shares in the business. Inventories of crops or livestock would continue to be purchased, owned, and sold by the business entity. The younger party would continue to have a tax basis in a share of the business equal to the purchase price for as long as he/she owns it.

In some cases, assets may be sold below market value to reduce the capital requirements for the younger party. If the assets are significantly undervalued, the IRS may consider that a partial gift has taken place. This may use up some or all of the annual gift tax exclusion (*AgDM File C4-23, Gift Tax*, www.extension.iastate.edu/agdm/wholefarm/pdf/c4-23.pdf) or a portion of the unified estate and gift tax credit (*AgDM File C4-24, Federal Estate Tax*, www.extension.iastate.edu/agdm/wholefarm/pdf/c4-24.pdf).

Summary

When deciding how to transfer machinery and breeding livestock from one party to the next, first consider whether the younger party is committed to farming, and whether his/her financial resources permit an immediate or a gradual transfer. Then,

income tax consequences for both the buyer and the seller should be considered for each of the possible transfer methods. Generally, income tax payments can be escaped only by gifting assets, but a gradual sale or lease/buy agreement can postpone tax liabilities for several years.

Regardless of the type of transfer agreement used, a written record of all terms and transactions and an accurate description of the property involved should be maintained for tax and other business purposes.

Additional resources on **Transition and Estate Planning** can be found by visiting the Ag Decision Maker website, www.extension.iastate.edu/agdm/wdbusiness.html.