

# Over The Wire

A Beef Cattle E-Letter for Area Cattle Producers

## Transferring Cattle to the Next Generation

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### *Time Moves On!*

According to USDA data, the average age of farmers and ranchers in the United States is 57 years old, with one quarter of that population being 65 or older. It is predicted that the average age will increase when the next Census of Agriculture is conducted.

The bottom line is that the agriculture industry is aging. If any of you have attended a cattle event or bull sale recently you would have to agree. There is a lot of gray hair in the audience.

We desperately need an influx of young people in this industry. We all know how hard it is to get started farming or ranching. The capital needed to secure land, machinery and livestock is unbelievable, which is why many young people are not able to choose farming or ranching as their career.

However, it is important to remember that there is hope and with careful planning, assets can be transferred from one generation to the next.

If you are a cattle producer and are at the age where you are starting to give some thought of retiring or letting a son or daughter take over the operation, there are options for transferring cattle from one generation to the next. Those options include; outright sale, installment sale, gradual sale, leasing and gifting. Let's look at each of these options.

### *Options for Transferring the Cattle Herd*

#### **Option 1. Outright Sale.**

In this option, all animals are sold to the buyer at an agreed upon price. This is the easiest option, but it requires a great deal of capital upfront for the buyer. It also may cause cash flow problems for the new buyer as well. In addition, the seller will have immediate tax consequences compared to other options.

#### **Option 2. Installment Sale.**

With this option, the owner sells the cattle over an extended period of time to the buyer. This may take several years. The two parties must agree on the value of the cattle at the beginning. Terms of the sale need to also be agreed upon by both the seller and buyer.

The advantages of this option is that it helps the buyer with cash flow, it may provide a lower interest rate if the seller is willing to reduce the interest, will allow for a longer repayment schedule and the payments can be timed with the sale of the calves.

Years ago I visited with a producer who shared how he purchased a cowherd using the installment option. The value of the cattle and the interest rate was determined at the beginning.

The possession of the cowherd was passed to the buyer. When the calves were sold the first year, the buyer paid the seller 1/3 of the value of the calf crop. The second and third years, the buyer paid 1/2 the value of the calves to the seller when the calves were sold. Year 4, what ever was still owed was paid to the seller. The cowherd was then owned free and clear by the buyer after 4 years.

This is just one example of an installment option. There can be many deviations from this depending on the needs of the seller and buyer.

Of course there are tax consequences that need to be considered. A tax accountant would need to be consulted prior to entering into an installment sale.

### **Option 3. Gradual Sale.**

With this option, a portion of the cattle are sold to the new owner each year. For example, the cull cows are sold with the seller keeping all the income. The replacements going back into the herd are purchased by the new owner. These can be raised heifers or purchased cows/heifers.

With this system it would take 5 to 6 years or more to transfer the herd to the new owner. The seller would have to report income for each animal sold in the tax year. The income would be from the sale of cull animals and the sale of replacements to the new owner.

### **Option 4: Lease the cowherd.**

Leasing the cowherd to a younger person is a great way for them to enter into the cattle business, especially if they do not have the money to purchase cows.

The owner of the cows and the person leasing them need to agree on many things prior to entering into a lease. How the cattle will be managed, who is responsible for replacements, bull selection and lease payment amounts are examples of what needs to be agreed upon and documented in a written agreement. There are several examples of lease agreements and worksheets available for parties wanting to enter into a lease agreement.

In most lease agreements, the payment is based on dividing up the cash received from the sale of calves. Depending on the lease arrangements, a typical split would be 1/3 to the owner and 2/3 to the person leasing the cattle.

I ran across a lease arrangement that is used in Nevada that I thought was pretty good. The specifics of this lease are as follows:

- ◆ Owner maintains ownership of the cows.
- ◆ The value of the cows is determined by the owner and the person leasing the cows. Value can be determined by monitoring the sale of comparable cows at area markets.
- ◆ Determine a fair interest rate if the cows were purchased using borrowed money. Local banks can offer insight into going interest rates.
- ◆ Replacements are supplied by the owner. Replacement heifers can be retained in the herd or purchased by the owner.
- ◆ Person that is leasing the cattle pays all the expenses.
- ◆ Person that is leasing the cattle gets all the income from the sale of calves (minus the replacement heifers) and culls.
- ◆ Annual rent is figured by multiplying the value of the cows times the interest rate. (value of cows x interest rate)

This is a simple way to setup a lease agreement allowing a young person to enter the business while allowing the owner to receive an interest payment as if loaning money while maintaining ownership in his/her cows.

### **Option 5: Gifting.**

The older generation can give the cattle to their relatives or other younger ranchers as a gift. They can be given all at once or gradually over a period of years.

**It is critically important to talk to a tax accountant before giving any cattle away as a gift.** There are tax laws that come into play. Each year a person can gift a certain amount of value to another person tax free. However, this figure changes so check with your accountant before making this decision.

## *Planning for a Transfer*

Plans for transferring the cattle herd to the next generation should be done early, don't wait until the son or daughter is 50 years old or older.

Teach and prepare your family members how to manage when they are young. Start by handing over control of one enterprise on the ranch when the son or daughter is in their 20's or early 30's. This would include all decisions on the enterprise such as budgeting, purchasing, marketing and whatever decisions need to be made. All aspects of the enterprise including talking to salesmen should be handled by the young person. This prepares the individual for the time when they will be responsible for managing the entire ranch.

Have regular business meetings. Weekly meetings are recommended. Do more listening than talking during the meetings. Develop a working agreement and succession plan, in writing, with dates for turning over control of the operation and stick to them. Planning will make the succession process much easier.

## *Summary*

I have just touched the surface of this topic. Hopefully I have helped you to start thinking about how you will transfer your cattle and other assets to your children, relatives or other young people.

There are options available for transferring assets. Please contact a tax consultant and or a lawyer with expertise on estate planning and the succession process. These experts are worth the money and you need them on your planning team.

If you are interested in leasing your cattle to someone, contact me. I have worksheets available at my office that will help you establish a fair agreement and lease rate.

Once again planning is the key. Start now, don't put it off for another month or year. Good luck!

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