

Critical Buying and Selling Decisions

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Decisions regarding buying and selling livestock will have an impact on tax obligations, current and future cash flow, the value of farm assets, and possibly net worth of the farm business. However, before worrying about these concerns, livestock producers should answer a more fundamental question regarding their future in the business. "Do you want to continue in the livestock business for the next several years?"

If the answer to this question is yes, then it is likely better to do whatever is necessary to maintain the foundation herd than to sell now with the expectation of replacing in the future. The reasons are two-fold.

First we need to recognize that this severe winter is an emergency situation that is likely to result in depressed demand for breeding stock in the immediate area. This is because many other producers are facing the same situation. As a result, the price received for the livestock sold is likely to be considerably less than the cost of replacing them once the crisis is over.

The second reason is the stage of the cattle cycle that we're currently in. At this time the cattle cycle is nearing the end of the liquidation phase, which means we should be at the bottom of the price cycle. This means that sale prices of breeding stock today are likely to be at the lowest level that they will be for the next six to ten years. This is further compounded by the current emergency situation.

This means that replacing the breeding herd later is almost guaranteed to result in a higher investment in the herd. In addition, there is always the concern about being able to replace the current herd with animals of equal quality.

If a producer is thinking of leaving the cattle business in the near future anyway, the decision to sell may be more justified. However there is still the concern with the depressed market in the short term.

Sales of breeding livestock trigger some tax consequences. Breeding livestock are considered capital assets and therefore subject to treatment as capital gains income. How much of the sales price is capital gains depends on the basis in the herd. If the herd has all been raised within the farm business there likely is no basis, and therefore the entire sales proceeds are subject to capital gains tax. Purchased animals that have not been fully depreciated will have a basis which will reduce capital gains. Capital gains income may trigger a tax obligation even if the business shows an operating loss for the tax year. This is due to the alternative minimum tax.

Producers should consult with their tax preparer before going ahead with any substantial liquidation.

If the intent is to replace liquidated breeding stock at a later date, a portion of the sales proceeds may be deferred for up to two years. This provision of the tax code is triggered by the county

being declared a federal disaster area. The quantity of sales on which the tax obligation may be deferred is limited. Only the number of animals in excess of the number that would normally be sold may be deferred. The quantity that would be considered normal sales is the average of the number sold the last three years. If the animals are replaced within two years by an equal number of animals of equal or greater value, the sales proceeds will not be subject to capital gains tax. If they are not replaced or are replaced with fewer animals or animals of lesser value, there likely will be some tax due.

Another concern will be the relationship between the sales price and the value at which these animal are carried on the balance sheet. If these animals are currently worth less in the market place than what they are valued on the balance sheet, there is an unrealized capital loss that may not affect the operation as long as they are not sold. However, once a sale occurs, this becomes a realized capital loss and must be reflected on a new balance sheet. This may result in a weakening of the financial position of the farm business which could negatively affect the credit worthiness of the operation.

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