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# Planning for Beef Cattle Operations in the Face of Drought

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# Cornhusker Economics

Cooperative Extension

Institute of Agriculture & Natural Resources  
Department of Agricultural Economics  
University of Nebraska – Lincoln

## Planning for Beef Cattle Operations in the Face of Drought

Market Report	Yr Ago	4 Wks Ago	5/12/00
<b><u>Livestock and Products,</u></b>			
<b><u>Average Prices for Week Ending</u></b>			
Slaughter Steers, Ch. 204, 1100-1300 lb Omaha, cwt. . . . .	64.00	73.59	\$72.25
Feeder Steers, Med. Frame, 600-650 lb Dodge City, KS, cwt. . . . .	77.10	97.10	92.58
Feeder Steers, Med. Frame 600-650 lb, Nebraska Auction Wght. Avg. . . . .	81.48	102.17	98.07
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt. . . .	100.33	113.05	116.19
Hogs, US 1-2, 220-230 lb Sioux Falls, SD, cwt. . . . .	37.75	51.00	48.00
Feeder Pigs, US 1-2, 40-45 lb Sioux Falls, SD, hd. . . . .	35.00	61.00	58.97
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt. . . .	116.35	135.20	117.20
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt. . . . .	87.13	81.08	103.25
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt. . . . .	183.75	170.00	210.00
<b><u>Crops,</u></b>			
<b><u>Cash Truck Prices for Date Shown</u></b>			
Wheat, No. 1, H.W. Omaha, bu. . . . .	2.77	2.82	2.96
Corn, No. 2, Yellow Omaha, bu. . . . .	1.98	2.03	2.08
Soybeans, No. 1, Yellow Omaha, bu. . . . .	4.40	5.06	5.14
Grain Sorghum, No. 2, Yellow Kansas City, cwt. . . . .	3.39	3.50	3.67
Oats, No. 2, Heavy Sioux City, IA, bu. . . . .	1.31	1.37	1.29
<b><u>Hay,</u></b>			
<b><u>First Day of Week Pile Prices</u></b>			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton. . . . .	100.00	85.00	92.50
Alfalfa, Lg. Round, Good Northeast Nebraska, ton. . . . .	*	47.50	47.50
Prairie, Sm. Square, Good Northeast Nebraska, ton. . . . .	55.00	*	70.00
* No market.			

Parts of Nebraska are extremely dry. Even timely rains are not likely to result in normal crop and grass production on non-irrigated ground. Livestock operations dependent on grass from April through the remainder of the year are greatly susceptible to problems. Below normal grass production will mean lower carrying capacities. Rainfall shortage may also impact livestock drinking water in areas with shallow wells and areas that depend on small earthen dams. Early planning usually offers more options since the options are often time dependent. But late planning is better than no planning.

### Options for Grazing Beef Cattle

Most beef cow-calf operations depend on grazed forage for spring, summer, fall and even early winter. Producers have two main options - increase the quantity and quality of grazed forage or reduce the demand for the same. What are some ways that the forage supply can be increased or extended? Leasing additional grassland is one alternative. Another is to feed more harvested forages/feeds either later into the summer or earlier in the fall, thus preserving some of the grass or pasture land. Another is to more intensively manage the pasture that one already has. Finally, a fourth would be to utilize some non-traditional forage such as grazing meadows or alfalfa instead of haying, or grazing other growing crops especially if they are irrigated. All of these options have associated costs and might even affect production. Cost/return impacts associated with the options often will be producer specific. A good plan will examine those impacts and determine whether or not they are feasible both in the short and long-run. Leasing additional forage may or may not be feasible depending on availability. It may require moving the livestock some distance via truck. In such cases the producer will likely be losing day-to-day contact with the livestock which may be another cost. Using some non-traditional forage for grazing such as meadows or other hay will reduce the amount of harvested hay available for use in the following year. Again the feasibility will depend on the producer's hay carryover and the cost of purchasing forage



from others. Forage quality is an important aspect that must be considered when feeding stored forage.

Reducing the demand or need for forage is another major option. This can be accomplished by reducing cattle numbers and/or by weaning early and either selling or placing the calves in a lot. These options also have associated short and long-run cost/return implications. Culling and selling the culls earlier than normal can reduce the overall forage demand. Selling non-breeding stock, e.g. yearling stocker cattle is an option available to some producers. These could be sold earlier than normal or not even retained after weaning. One must be cognizant of seasonal price relationships as well as effects of early sales on sale weight. Cull cow prices tend to be lowest in October and November. Sales earlier in the year could possibly benefit from normally stronger prices. However, depending on the size of the drought area, the seasonal price patterns could be affected. Selling culls before the drought forces many cows to market could be a plus. Similarly, calf prices tend to be lowest in October and November. Early sales of calves and yearlings might result in above average prices if the traditional seasonality of prices hold.

Selling part of the breeding herd is another option for reducing forage demand. This option requires the most serious analysis. Selling part of the breeding herd (non-culls) has important long-run implications. In the short-run, selling cows will generate cash flow dollars that can be used to pay expenses or reduce debt. But in the long-run, what does such an action do to the overall output of the “manufacturing plant?” If a bred cow or cow/calf pair is sold today, expenses for the remainder of the year will be reduced. But, income from the sale of the calf later in the year will also be gone. And if the cow is not replaced, the income from future calves will be lost so there will be fewer dollars to cover the overhead costs which are not likely to decrease with fewer cows. In essence, the overhead costs of the cow/calf operation will be spread over fewer production units so unit costs of production will increase. If the cows sold are eventually replaced, cash will need to be available to acquire the replacement. The cash flow gain of selling the cow now will be offset by the need for cash to replace it. Because of the seriousness of reducing future income, selling part of the breeding herd appears to be one of the last options the producer may want to use.

The relationship between the producer and her/his financing institution may be a critical aspect of the planning process. If the producer needs additional financing to get through the dry period, will the financial institution be willing to provide that financing? The current strength in cattle prices is a plus that should encourage financial institutions to work with producers to get through this dry period.

### **Income Tax Implications**

Sales exceeding “normal” may have income tax implications that must be considered in the planning process. Sale of additional market livestock may result in added income in a given year, which could move a producer to a higher tax bracket. Income averaging may help, but income averaging is not available for FICA taxes. Breeding livestock sales are

treated as a capital gain (loss) and thus will be subject to a maximum tax of either 10 or 20 percent.

**IRS rules (Paragraph 451 {e})** permit producers to defer “extra” income into the following year. This section applies to the sale of “all” livestock above those considered “normal.” Normal is determined by averaging the number of cattle sold in each of the three preceding years. Use of this section has several requirements, which must be met or filed with IRS.

- a. Requires that the Federal Government declare a disaster area. Livestock need NOT be in the declared disaster area. Producer must include evidence of the existence of drought condition that forced the early sale or exchange of livestock and the date, if known, on which area was designated as eligible for assistance by the federal government due to drought. Producer must also include a statement explaining relationship of the designated drought area to the taxpayer’s early sale or exchange of livestock
- b. Number of animals that would have been sold in the taxable year had the taxpayer followed his or her normal business practice in the absence of drought must be shown, plus the number sold on account of drought during the taxable year.
- c. A computation of the amount of income to be deferred must be included.

In addition to these requirements, the taxpayer’s principal business must be farming/ranching and they must use the cash method of accounting for tax purposes.

**IRS rules (Paragraph 1033 {e})** permits the producer to postpone the gain from the sale of excess **breeding** livestock for up to two years on the condition that those animals will be replaced sometime during those two years. Use of this section requires that excess animals be replaced by purchase on a one-for-one basis and for at least equal value. Suppose a producer sells 15 head above “normal” that have a zero basis (the case for raised breeding stock) and elects to defer \$9,000 gain on those 15 head. Within two years the producer must spend at least \$9,000 on the acquisition of at least 15 head. If the producer spends \$9,000 on only 14 head then he/she must go back to the year of deferment and amend that year’s income tax return to reflect a \$600 gain for one animal (the average value deferred). Likewise, if less than \$9,000 is spent on 15 head, the tax return for the year of deferment must be amended to report that difference. An official drought disaster area does **not** need to be declared for use of these provisions; however, producer must provide evidence that excess sales were caused by dry conditions. **The bottom line for tax implications is that producers should consult their tax advisors prior to selling livestock due to the drought!**

While planning will not solve the drought problems, planning can help producers financially withstand the effects.

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