ProgressiveFarmer.com

A Boarding House for Cows

When the tax man came calling, Cynthia Hughes had to decide whether to bail out or dig in.

By Del Deterling

Strapped for cash, Cynthia Hughes put her money into forage improvement instead of owning cattle. PHOTO: Del Deterling

After Cynthia Hughes took over the ranch that had been in her family's name for three generations, she asked several people for advice on how to keep the cow/calf operation profitable. Ultimately, the people who collect estate taxes had the greatest say on how the ranch would be run.

Facing a sizeable estate-tax bill, Hughes sold the cows to raise cash. When she was unable to line up a satisfactory lease arrangement for the land, she even posted a "For Sale" sign for awhile.

But in spite of her lack of ranch-management expertise, the divorced mother of two was reluctant to part with the place her grandfather, R.Q. McSwane, had cobbled together near Buffalo, Texas, in the early 1950s. So she and her manager, Donna Shaw, came up with an alternate plan.

"Rather than tying up money in cows, we decided to invest in improving the grass and fences," Hughes reports. "Instead, we've become a boarding house for other people's cattle.

"I'm still making annual payments for estate taxes," she says. "But by boarding other people's cattle, we're generating the cash-flow to keep our heads above water."

The McSwane Ranch currently stocks about 500 cows and their calves on 1,700 acres of improved bermudagrasses, clovers and vetch. Hughes' goal is to push that number to 650 cows. She established deer habitat, stocked a 7-acre pond with fish and is developing a 40-acre duck pond. A bed-and-breakfast venture also is a possibility.

"These two ladies have done a remarkable job of improving the quality of the forage and developing an efficient grazing program," notes David Bade, Texas A&M forage agronomist. Shaw suggested to her boss that they turn to Bade for advice on forage management.

Hughes came to the ranch in 1991 to take care of her mother, who had inherited the ranch from her father in 1989. Her mom died three years later. "Mother had a will, but unfortunately she died before she had time to gift enough of the assets to her heirs to avoid estate taxes," Hughes explains. At the time, tax laws provided an exemption of $600,000 before estate taxes became due. That limit and other gifting provisions have been raised since then.

"The IRS has three years to make a determination of how much tax is owed," Hughes says. The final ruling came about two weeks before their deadline.

"I can pay the taxes over a 15-year period, but I had to come up with a sizeable down payment right away," she continues. "We had no choice but to sell the cows to raise enough cash. I took a pretty bad beating, because I had to sell them in a hurry during the summer."

The next question was what to do with the land. Hughes didn't want to sell and couldn't negotiate an acceptable lease. A year after selling the cows, she and Shaw began grazing cattle for other ranchers. But they couldn't stock heavily enough to make the ranch pay. That's when they called on Bade for assistance.

Hughes' grandfather had sprigged 500 acres to Coastal bermudagrass, some of which was lost because of improper management. Bade suggested sprigging 65 acres to Tifton 85 and adding 60 acres of Jiggs bermudagrass. Tifton would work well on the ranch's sandy soils and was more drought tolerant. Jiggs is easy to establish and is favored by horse owners.

Hughes overseeded 300 acres of bermuda with ball clover and 40 acres with Tripoli white clover. Common bermudagrass and bahiagrass pastures also have a good amount of native clovers and vetch.

Soil samples determined that the soils needed phosphorus and potash, in addition to nitrogen. Bade also recommended that they switch from Grazon P+D to 2,4-D to control weeds in pastures that contained clovers. Hughes' goal is to let the legumes provide all the nitrogen needed by the grasses and to allow solid stands to crowd the weeds.

Hughes has continued to board other people's cattle, freeing her limited capital for forage improvement. She deals primarily with four owners, using month-to-month contracts. Basic charges are $10 to $12 per cow, $12 to $14 for a pair or for a bull, and $7 to $9 for a yearling.

"We fill an important niche," Hughes maintains. "There aren't too many places that can take in and handle 500 cows on a yearly basis."

"The owners work their own cattle and handle the breeding and calving," Shaw explains. "Our responsibility is to make sure they get adequate nutrition."

That nutrition has to come primarily from grass. Hay supplied by the owners is fed only if there is ice on the ground. They also must supply supplemental feed.

The ranch is now divided into 17 pastures ranging from 10 to 130 acres each. Hughes and Shaw use ATVs to move cattle.

Better Tax Breaks

If Cynthia Hughes' mother had lived a few years longer, her family likely would not have faced an estate-tax problem. Legislation passed by Congress last year greatly eases the potential estate-tax liability for farm businesses.

Beginning in 2002, heirs of a person who dies (other than the surviving spouse) do not have to pay estate taxes on assets worth less than $1 million. That's up from the $600,000 limit that was in effect in 1994 when Hughes' mother died. Spouses can still inherit an unlimited amount of assets without having to pay estate taxes.

That exemption will increase to $1.5 million in 2004 and will rise to $2 million in 2006 and $3.5 million in 2009. In 2010, the estate tax is zero. But it reverts back to $1 million in 2011, unless Congress rewrites the law-which is always a possibility.

Other key changes include the following:

A person can make an annual gift of $11,000 (up from $10,000) to any number of people without incurring the gift tax.

The exclusion from gift taxes for a lifetime gift is now capped at $1 million.

The generation-skipping transfer lifetime exemption was increased from $1.06 million to $1.1 million.

The maximum estate- and gift-tax rate drops by one percentage point per year, from 50% in 2002 to 45% in 2007.

Even at the higher limits, farm owners need to continue tax planning, according to Lane Keller, a certified public accountant in Victoria, Texas. "It doesn't take much real estate to push assets above the $1-million mark, or even $2 million," he notes.

Keller adds that the new laws have further complicated an already complex process. He points out that many wills have been written to leave the maximum amount that could go free of estate taxes to children, with the balance left to the surviving spouse. With the higher limits and leaving those assets outside of a "bypass trust" to benefit the surviving spouse, this unintentionally may impoverish the survivor.

The terms of a bypass trust also must be carefully considered, especially when dealing with children from prior marriages, current marriages or both. Generally, descendants are also beneficiaries of the bypass trust and may have different ideas about distributions to the surviving spouse.