

Weather-Related Sales of Livestock*

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Introduction

There are two provisions in tax law which attempt to cushion producers from the consequences of adverse weather-related livestock sales. Under the first provision, livestock held for draft, breeding or dairy purposes and sold due to adverse weather are provided a two-year reinvestment period. This replacement period can be extended if weather conditions persist for more than three years. The second provision, which applies to all livestock (other than poultry), allows cash basis taxpayers whose primary trade or business is farming to defer receipt from sales in excess of normal business practices due to weather-related conditions that result in a disaster declaration area. Both provisions apply only to those sales which are in excess of “normal sales” for the producer. The two tax provisions for weather-related sales of livestock have similar but different requirements. Producers should evaluate their circumstances to see which would be of greater tax benefit.

Involuntary Conversion of Draft or Breeding Animal IRC Sec 1033(e)

A livestock producer who sells more draft, breeding, or dairy animals than normal due to weather-related conditions may defer recognition of the gains for up to two years. The animals must be replaced within two years with other animals used for identical purposes. This applies only to the number of animals sold in excess of normal business practices. Declaration of a disaster area is not necessary, but the producer must be able to show that weather-related conditions forced the sale of more livestock than would normally be sold. Tax basis of the replacement livestock is equal to the basis in the livestock sold plus any additional amount invested in the replacement livestock that exceeds the proceeds from the sale. If the animals are not replaced, or if replacement cost is less than the gain from their sale, the difference must be reported as a gain for the sale year by amending the tax return. The return will be subject to additional tax and interest.

* In cooperation with the participating land-grant universities, this project is funded in part by USDA-Risk Management Agency under a cooperative agreement. The information reflects the views of the author(s) and not USDA-RMA. For a list of participating land-grant universities, see RuralTax.org.

Example 1: Bo Vine normally sells five cows per year. This year Bo sells 20 cows because of weather-induced limited forage and feed supplies. Gains from the sale of the 15 cows sold in excess of normal business practice would not be reported as income if Bo purchases replacement animals that cost as much or more within the next two tax years.

a) Bo sells 20 raised beef cows (with a \$0 tax basis) for \$500 each. The gain of \$7,500 (15 cows X \$500) is deferred. If Bo purchases 15 cows for \$500 each, the tax basis in the replacement animals would be zero. If the replacements cost \$600 each, the tax basis in the replacement animals would be \$100 each (\$600 cost minus the \$500 proceeds from sale).

b) Bo sells 20 purchased beef cows (with a remaining \$200 tax basis) for \$500 each. If Bo purchases 15 cows for \$500 each, the tax basis in the replacement animals would be \$200 each. If the replacements cost \$600 each, the tax basis in the replacement animals would be \$300 each (\$600 cost minus the \$500 proceeds from sale plus \$200 remaining basis).

Making the Election

The producer makes this election by attaching a statement to his or her tax return. The election must include the following information:

- Name, address, and ID number.
- Evidence of the weather-related conditions that forced the sale or exchange of animals.
- Explanation of how the sale is related to weather conditions.
- Number and kind of livestock sold or exchanged.
- Number of livestock of each kind that would have been sold or exchanged under normal business circumstances. Generally use number of animals sold the three preceding years
- Computation of the amount of gain realized on the sale or exchange.
- The amount of income to be postponed

Example Statement 1:

Election under I.R.C. §1033(e) to Postpone Recognition of Gain from Livestock Sold Because of Weather-Related Conditions

Bo Vine EIN 12-3456789
145 County Road 541
Somares, US 12345

The weather-related conditions evidenced by the attached rainfall reports and news clippings affected availability of forage and feed, and caused taxpayer to sell 20 head of beef cows instead of 10 head in 2011. The raised cows have zero basis.

The number of animals sold in each of the three preceding years was:

2008 12 head
2009 11 head
2010 8 head

The three year average is 10 head

The 25 beef cows were sold for \$12,500 in 2011. Taxpayer elects to postpone the \$7,500 gain on the 15 extra head sold.

Computation of income to be postponed:

25 head sold in 2006	\$12,500 total gain realized
<u>-10</u> three year average	\$ 500 total gain per head (\$12,500/25)
15 head sold due to weather-related conditions	\$ 7,500 total gain elected postponed to 2012 (\$500 x15)

Deferral of Income for One Year of Sale of Market Animals IRC Sec 451(e)

Livestock producers using the cash method of accounting can elect to defer for one tax year the income of certain livestock sold due to weather-related conditions. The area must be federally recognized and declared as eligible to receive federal assistance. It is not necessary that the animals are raised or sold in the declared disaster area; just that a weather-related event caused the area to receive the federal disaster designation and caused the sale of the animals. However,

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only the livestock sales in excess of normal business practice qualify for deferral. The animals are not replaced and the elected gain is simply put off to the next year.

Example 2: Due to weather-related conditions, Guy Wyre sold 150 head of calves in 2011 instead of the usual 75. He received \$50,000 for the 150 head. Guy makes an election under IRC Section 451(e) by the due date of the return (including extensions) for the tax year in which the area was designated a federal disaster area.

Making the Election

The producer makes this election by attaching a statement to his or her tax return. The election must include the following information:

- Name, address, and ID number.
- A declaration that the elections is made under I.R.C. §451(e).
- Evidence of weather-related conditions that forced the sale or exchange of animals and federal disaster designation.
- Explanation of how the sale is related to weather conditions.
- Number of livestock of each kind that would have been sold or exchanged under normal business circumstances. Generally use number of animals sold the 3 preceding years.
- Total number of animals sold in the current year, and the number sold due to the weather-related circumstance.
- The amount of income to be deferred.

Example Statement 2:

Election to Defer Livestock Sales Due to Adverse Weather

Guy Wyre EIN 98-7654321
541 County Road 123
Somareselse, US 54321

Taxpayer makes election under § 451(e) of the Internal Revenue Code to defer the following livestock sales in 2011 to 2012 due to adverse weather.

Decatur County, US, was designated as eligible for assistance by the federal government on July 3, 2011, because of drought and high temperatures from January 1, 2011, and continuing. Taxpayer's farm is located in Decatur County and the drought forced the early sale of beef calves.

The number of animals sold in each of the three preceding years was:

2008 65 head

2009 100 head

2010 60 head

Total 225 head

The three-year average is 75 head

The number of animals that would have been sold in 2011 following normal business practice is 75 head. The total number of animals sold in 2011 was 150 head, the total gain realized was \$50,000, and the number sold because of weather-related conditions in 2011 was 75 head.

Computation of income to be postponed:

150 head sold in 2011	\$50,000 total gain realized
- 75 three year average	\$ 333 total gain per head (\$50,000/150)
75 head sold due to weather-related conditions	\$25,000 total gain elected postponed to 2012 (\$333 x 75)

Total Amount deferred to 2012 = \$25,000

IRS Publications

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- **IRS Publication 225, Farmer’s Tax Guide.** Chapter 11 discusses casualties, thefts, and losses including weather-related sales of livestock.

Additional Topics

This fact sheet was written as part of Rural Tax Education a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

Related articles that might be helpful include:

- Involuntary Conversion of Business Assets
- Like-kind Exchange (Trade) of Business Assets
- Sale of Business Property

This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

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