RURAL TAX EDUCATION

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Weather-Related Sales of Livestock*

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Introduction

There are two provisions in tax law that 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 that are in excess of “normal sales” for the producer. The two tax provisions for weather-related sales of livestock have slightly different requirements, so 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.

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This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Example 1: Bo Vine normally sells 25 cows per year. This year Bo sells 40 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 40 raised beef cows (with a $0 tax basis) for $50,000. The gain of $18,750 ($50,000 / 40 cows x 15 cows) is deferred. If Bo purchases the replacement cows for $18,750, the tax basis in the replacement animals would be zero. If the replacements cost $20,000, the tax basis in the replacement animals would be $1,250 ($20,000 - $18,750 of deferred gain). The $1,250 could then be depreciated over their MACRS depreciable life or expensed using the IRC Section 179 Expensing election.

b) Bo sells 40 purchased beef cows (with a remaining $16,000 tax basis) for $50,000. The gain of $18,750 ($50,000/40 cows x 15 cows) is deferred. If Bo purchases the replacement cows for $18,750, the tax basis in the replacement animals would be $16,000. If the replacements cost $21,000, the tax basis in the replacement animals would be $2,250 ($21,000 cost minus the $18,750 of gain deferred plus $16,000 remaining basis). The $2,250 could then be depreciated over their MACRS depreciable life or expensed using the IRC Section 179 Expensing election.

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, the average number of animals sold over the three preceding years).
- 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 (Taxpayer Identification Number)
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 40 head of beef cows instead of 25 head in 2021. The raised cows have zero tax basis.

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

Example Statement 1: continued

2018	28 head	
2019	23 head	
<u>2020</u>	<u>24 head</u>	
Total	75 head	The three-year average is 25 head

The 40 beef cows were sold for $50,000 in 2021. Taxpayer elects to postpone the $18,750 gain on the 15 extra head sold.

Computation of income to be postponed:

40 head sold in 2021	$50,000 total gain realized
<u>-25</u> three-year average sale (reported in 2021)	$31,250 gain ($50,000 / 40 * 25)
15 head sold due to weather-related conditions and electing to be postpone the gain.	$18,750 deferred gain ($50,000 / 40 * 15)

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

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 <u>must</u> be federally recognized and declared as eligible to receive federal assistance. It is not necessary for the animals to be raised or sold in the declared disaster area, just that a weather-related event caused the area to receive federal disaster designation and caused the sale of the animals. However, only 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 130 head of calves in 2021 instead of the usual 75. He received $123,500 for the 130 head. Guy makes an election under IRC Section 451(g) 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 election is made under I.R.C. § 451(g).
- 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 the average number of animals sold over the three 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 (Taxpayer Identification Number)
541 County Road 123
Somareselse, US 54321

Taxpayer makes election under § 451(g) of the Internal Revenue Code to defer the following livestock sales in 2021 to 2022 due to adverse weather.

Decatur County, U.S., was designated as eligible for assistance by the federal government on July 3, 2021, because of drought and high temperatures beginning January 1, 2021. 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:

2018	65 head	
2019	100 head	
2020	60 head	
Total	225 head	The three-year average is 75 head

75 animals would have been sold in 2021 following normal business practice. The total number of animals sold in 2021 was 130 head, the total gain realized was $123,500, so the number sold because of weather-related conditions in 2021 was 55 additional head.

Computation of income to be postponed:

130 head sold in 2021	$123,500 total gain realized
- 75 three-year average	$71,250 gain reported in 2021
55 head sold due to weather-related conditions and elected to postpone the gain to 2022	$52,250

Example 3:

Had Guy Wyre, in Example 2, sold breeding animals instead of market animals due to the lack of forage, the same rules would apply. Guy sold an additional 30 head of cows for $80,000 over his normal number of cull animal sales. The county in which his ranch exists was declared a federal disaster area. He makes an election under IRC Section 451(g) by the due date of the current year's return to postpone taxing the extra $80,000 of income until the following tax year thus managing his taxable income.

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