

Weather-Related (Drought) Sales of Livestock: Income Tax Management Issues

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Weather-Related Sales of Livestock

- **Applies to sales of livestock due to weather-related conditions: flood, drought, or other weather-related condition causing a shortage of water and/or feed.**
- **Allows taxpayer to postpone recognition of income from the sale proceeds (to avoid bunching of income).**

Sources for Drought and Disaster Information

- FEMA – Presidential declarations
- Farm Service Agency (FSA) – Secretary of Agriculture declarations
- U. S. Drought Monitor – State and National drought intensity maps refer to <http://droughtmonitor.unl.edu/>

Two Different Tax Treatments

- Both tax treatments or rules apply to sales in excess of usual or normal due to weather-related conditions.
- The first applies to sales of any livestock (**IRC § 451(e) Deferral of Income for 1 Year**).
- The second applies to sales of livestock (other than poultry) held for draft, breeding, or dairy purposes (**IRC § 1033(e) Involuntary Conversion**).

Two Types of Taxable Income

- **Ordinary Income**
 - Sale of calves
 - Recapture of Depreciation from Purchased Breeding Livestock
- **Capital Gain Income**
 - Sale proceeds from Raised Breeding Livestock
 - Sale proceeds from Purchased Breeding Livestock in excess of purchase cost

1. Deferral of Income for 1 Year IRC §451(e)

- *The drought, flood, or other weather-related condition must be of such severity that an area affecting the taxpayer's area is designated as eligible for Federal disaster assistance.*
- A taxpayer needs to show that the weather-related condition caused the sale of more animals than normal.
- Farmer (taxpayer) must use the cash method of accounting.

1. Deferral of Income for 1 Year

IRC §451(e)

- **Applies to any livestock (including draft, breeding, or dairy animals) sold due to weather-related conditions.**
- **Sale proceeds (income) may be deferred to the next taxable year, however certain requirements must be met.**

1. Deferral of Income for 1 Year

IRC §451(e)

Requirements that the taxpayer must meet:

- 1. Principal business must be farming (50% of gross income must come from farm business).**
- 2. Must use the cash method of accounting.**
- 3. Must show that the animals would normally have been sold in the following year.**
- 4. The weather related condition that caused the area to be declared eligible for Federal assistance must have caused the sale.**

1. Deferral of Income for 1 Year

IRC §451(e)

- The livestock do not have to be raised or sold in the declared disaster area, but the weather-related condition that caused an area to be declared eligible for federal assistance must have caused the premature sale of the livestock.

1. Deferral of Income for 1 Year

IRC §451(e)

- The sale can take place before or after an area is declared eligible for federal assistance as long as the same weather-related condition caused the sale.
- Taxpayer's history is used to determine the number of animals that would have normally been sold compared to those sold prematurely.

1. Deferral of Income for 1 Year

IRC §451(e)

- **The sale proceeds from those animals that were sold prematurely, can be deferred and reported as income in the year following the year of the sale.**
- **Attach a statement to tax return showing normal and excess sales and evidence of the weather-related conditions causing the county to be declared a Federal disaster area.**

2. Involuntary Conversion

IRC §1033(e)

- **Must plan to purchase replacement draft, breeding, or dairy livestock within a 2 year period. (This rule does not apply to poultry or calves.)**
- **Replacement period can be extended from 2 years to 4 years if the area has been declared eligible for disaster assistance by the Federal government or by one of its agencies.**
- **If drought persists for more than 3 years, the replacement period can be longer.**

2. Involuntary Conversion

IRC §1033(e)

- **Livestock (draft, breeding, or dairy) held for any length of time and a weather-related condition caused the sale.**
- **Gain realized from the sale can be postponed if the sale proceeds are used to purchase replacement livestock within the time period previously described.**
- **Replacement animals must be used for the same purpose as those sold. (dairy for dairy and breeding for breeding)**

2. Involuntary Conversion

IRC §1033(e)

- **There is no requirement that the weather-related conditions cause the area to be declared a disaster area by the Federal government for the involuntary conversion rules to apply.**
- **A taxpayer needs to show that the weather-related conditions caused the sale of more animals than normal.**

2. Involuntary Conversion

IRC §1033(e)

To make the election to defer, attach a statement to the tax return showing:

- **Evidence of the weather-related condition.**
- **Computation of the amount of gain realized.**
- **Number and kind of livestock sold.**
- **Number and kind of livestock that would have been sold under usual or normal business practices.**

Replacing the Cows

- **Must replace as many dollars as was sold to postpone all the gain until the new cows are sold.**
- **Must keep track of dollars spent and tax basis.**

Which Option to Select

- **Not an easy answer.**
- **Everyone's economic situation, tax situation, and goals will be different.**
- **Consider the following points!**

Points to Consider (cont)

- **Future income tax rates**
 - 2012 = 10, 15, 25, 28, 33, and 35%
 - 2013 (projected) = 15, 28, 31, 36, and 39.6%
- **Future capital gain rates**
 - 2012 = 0 or 15%
 - 2013 (projected) = 10% or 20%

Change in Economic Circumstances: Now What?

- **If is not feasible to reinvest proceeds in replacement livestock, producer can invest in similar or related in business use property including real property**

Which Method to Select?

**Refer to RuralTax.org and Tax Topics:
Weather-Related Sales of Livestock
Take the information to your tax preparer
and have them evaluate the tax
consequences of each alternative.
(1033(e) Involuntary Conversion vs.
451(e) Deferral of Income for 1 Year)
Everyone's situation will be different!!!**

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