WEATHER-RELATED SALES OF LIVESTOCK

Philip E. Harris
Department of Agricultural and Applied Economics
Center for Dairy Profitability
University of Wisconsin-Madison/Extension

Taxpayers who sell livestock due to a feed shortage caused by weather have two options for postponing the income that is realized from the sale.

Livestock producers who are forced to sell animals because of weather-related conditions, such as flood, drought, or other conditions that cause a shortage of water or feed, may be eligible to postpone recognition of income from the proceeds, thus avoiding bunching of income.

Two different tax treatments can defer recognition of income arising from weather-related sales of livestock in excess of normal business practices. The first applies to draft, breeding, or dairy animals that will be replaced within a 2-year period. The second applies to all livestock and allows a 1-year postponement of reporting the sales proceeds as taxable income.

Involuntary Conversion [I.R.C. § 1033(e)]

The sale or exchange of livestock (other than poultry) held for draft, breeding, or dairy purposes in excess of the number ordinarily sold in the producer's usual or normal business practice is treated as an involuntary conversion if the additional livestock are sold or exchanged solely because of drought, flood, or other weather-related conditions, I.R.C. § 1033(e).

If livestock (other than poultry) **held for any length of time** for draft, breeding, or dairy purposes are sold because of weather-related conditions, the gain realized on the sale does not have to be recognized if the proceeds are used to purchase replacement livestock within 2 years from the end of the tax year in which the sale takes place. The 2-year replacement period is extended to 4 years if the weather condition that caused the excess sales also caused an area to be eligible for assistance by the federal government. It can be further extended by the Secretary of Treasury if the weather condition continues for more than 3 years [I.R.C. § 1033(e)(2)].

> Practitioner Note
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> No Required Holding Period
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> There is no required holding period for this provision as there is in I.R.C. § 1231.

Generally, the new livestock purchased must be used for the same purpose as those sold because of weather-related conditions. Breeding stock must be replaced with breeding stock, and dairy cows with dairy cows. However, if the condition that caused the involuntary conversion also makes it infeasible to replace the livestock with similar livestock, then the livestock can be replaced with any property, including real property, used in the farming business [I.R.C. § 1033(f)].

There is no requirement that the weather-related conditions cause an area to be declared a disaster area by the federal government. The taxpayer must show the weather-related condition caused the sale of more livestock than would normally have been sold. Only the additional animals sold in excess of normal sales can be sold and replaced without recognition of gain. If the taxpayer normally sells one-fifth of the herd each year, only the sales in excess of one-fifth of the herd will qualify for deferral.

The taxpayer will have a basis in the replacement livestock equal to the basis in the livestock sold, plus any amount invested in the replacement livestock that exceeds the proceeds from the sale.

Election

The election to defer recognition of gain is made by attaching a statement to the tax return that includes the following information:

- Evidence of the weather-related conditions that forced the sale or exchange of the livestock
- A computation of the amount of gain realized on the sale or exchange
- The number and kind of livestock sold or exchanged
- The number of livestock of each kind that would have been sold or exchanged under usual business practices of the taxpayer

Deferral of Income for 1 Year [I.R.C. § 451(e)]

Cash-method farmers can elect a 1-year deferral of income received from certain livestock sales made because of drought, flood, or other weather-related conditions. **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 assistance.** To qualify for deferral, the taxpayer must show that he or she sold more livestock than he or she would ordinarily have sold had there been no drought, flood, or other weather-related condition. Thus, this election also applies only to sales in excess of normal or usual sales [I.R.C. § 451(e)].

If *any* livestock are sold because of qualifying weather-related conditions, the taxpayer may be eligible for an exception to the general rule that sales proceeds must be reported in the year received. To defer income to the next year, the following requirements must be met:

1. The taxpayer's principal business must be farming as defined in I.R.C. § 6420(c)(3).
2. The taxpayer must use the cash method of accounting.
3. The taxpayer must show that the livestock would normally have been sold in the following year.
4. The weather-related conditions that caused an area to be declared eligible for federal assistance must have caused the sale of the livestock.

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. 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.

The number of animals that would normally be sold is determined primarily from the taxpayer's history. If the taxpayer usually holds all calves until the year after they are born before selling them, but was forced because of weather-related conditions to sell them in the year they were born, the proceeds from this sale may be reported in the year following the year of the sale.

Due Date of Election

The due date of the election depends on the classification of the livestock:

1. If the livestock is held for sale in the ordinary course of business, the election must be made by the due date of the return (including extensions) for the tax year in which the drought sale occurred.
2. If the livestock is held for draft, breeding, or dairy purposes, then beginning with tax years for which the return is due after December 31, 2002, the election can be made any time in the 4-year replacement period for the postponement of gain from sales caused by a disaster that resulted in a disaster area declaration under I.R.C. § 1033(e)(2).

Options for Deferring Income

The two weather-related sales of livestock tax provisions have similar but different requirements. Weather-related sales of breeding stock could qualify for either provision. Figure 1 compares and contrasts the requirements and tax benefits. Affected taxpayers can determine which provision provides the greatest tax benefit.

FIGURE 1: COMPARISON OF WEATHER-RELATED SALE OF LIVESTOCK TAX CONSEQUENCES

	Alternative Weather-Related Tax Provisions	
	Postpone gain by purchasing replacement [I.R.C. § 1033(e)]	**Defer income for 1 year [I.R.C. § 451(e)]**
Tax benefit	Gain is deferred if replacement requirements are met within the next 2 years*	Recognition of income is postponed by 1 year
Tax provision is allowed for	Sales in excess of normal practice only	Sales in excess of normal practice only
Qualifying livestock	Draft, breeding, or dairy livestock	All livestock
Requirement that area be designated eligible for federal assistance?	No, but designation increases replacement period from 2 to 4 years	Yes
Weather-related condition must have caused the sale?	Yes	Yes
Livestock must have been sold in the designated assistance area?	No	No
Livestock must be located in the designated assistance area?	No	No
Purchase of replacement livestock required?	Yes	No
Basis in replacement livestock	Reduced by the amount of gain deferred	N/A
Deadline for replacement	Generally 2 years after the end of the tax year of sale (4 tax years after the year of sale if an area is designated eligible for federal assistance because of the condition that caused the sale)	N/A
Deadline for making the election	2 years after the end of the tax year of the sale	Generally, due date of tax return for year of sale, but 4 years after year of sale for sales that qualify for the 4-year replacement period under I.R.C. § 1033(e)(2)

* Extended to 4 years if disaster-area related; can be extended further by Secretary of Treasury