Income Tax Issues: Weather-Related Sales of Livestock

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Weather-Related Sales of Livestock

• Special Income Tax reporting may be available for
  – Sales in excess of normal business practice
  – Caused by weather-related conditions
    • Drought
    • Flood
    • Other conditions causing a shortage of water and/or feed

• Special rules depend on
  – Whether market or breeding livestock
  – Whether disaster declaration issued
Involuntary Conversion
Internal Revenue Code Sec. 1033(e)

• Applies to breeding, dairy or draft livestock
  – No holding period requirement
  – Does not apply to livestock held in the ordinary course of trade or business (Market Livestock)

• Held for Breeding
  – Animal determined to be “held for breeding” when selected for addition to breeding herd
  – Raised Animals – Selection made when animals selected to remain on farm for addition to breeding pool, rather than for sale as market livestock
  – Purchased Animals – Selection generally made when animal is purchased and brought to farm
    • Animals purchased before reaching useful age???
I.R.C. Sec. 1033(e) Rules

• Reporting gain postponed by purchasing replacement animals
  – Replacement period runs 2 years from end of sale tax year
  – No federal disaster declaration needed

• Special Rules
  – Replacement period is 4 years if weather conditions lead to federal disaster declaration
    • Replacement period can be further extended by IRS in cases of on-going drought
  – Replacements must be like use
    • If sale conditions also make like use replacement impossible, replacement can be made with any property
    • No disaster declaration required to replace with unlike property if like-use replacement prevented
Understanding Deferral of Gain

• Deferral of gain based on sale $ per head

• If 10 animals sold at $600/hd, then at least 10 animals must be repurchased at at least $600/hd
  – If 9 animals repurchased at $700/hd, $600 sale of animal not replaced must be reported on amended return
  – If 12 animals repurchased at $550/hd, $500 of gain (10 hd x $50) must be reported on amended return for the 10 replacement animals repurchased below original animals’ sale price
Sec. 1033(e) Special Rules

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• Replacements must be like use
  – If sale conditions also make like use replacement impossible, replacement can be made with any property
  – No disaster declaration required to replace with unlike property if like-use replacement prevented
1 Year Deferral of Income

• Election made under Internal Revenue Code Sec. 451(e)

• Applies to all livestock (market and breeding, dairy, draft)

• Taxpayer
  – Principal business must be farming
  – Must use cash method of accounting

• Weather-related conditions must also cause federal disaster declaration
Making an Election

• Internal Revenue Code Sec. 451(e)
  – Election must be made by due date of return, including extensions, for the sale year
  – Election can be revoked, but cannot be made on an amended return

• Internal Revenue Code Sec. 1033(e)
  – Election can be made any time during replacement period (2 years, or 4 years)
  – If election revoked, gain must be reported in year of sale
Animals Eligible for Either Election

• Animals (breeding, dairy, draft) eligible for either election (Federal disaster declaration)

• Special rules permit revocation of Sec. 1033(e) election and adoption of Sec. 451(e) election during 4-year replacement period
  – Allows election of one-year reporting deferral (reporting in year following sale year) on amended return
  – Permits avoidance of reporting in sale year if Sec. 1033 (e) election made, and replacement subsequently deemed impractical