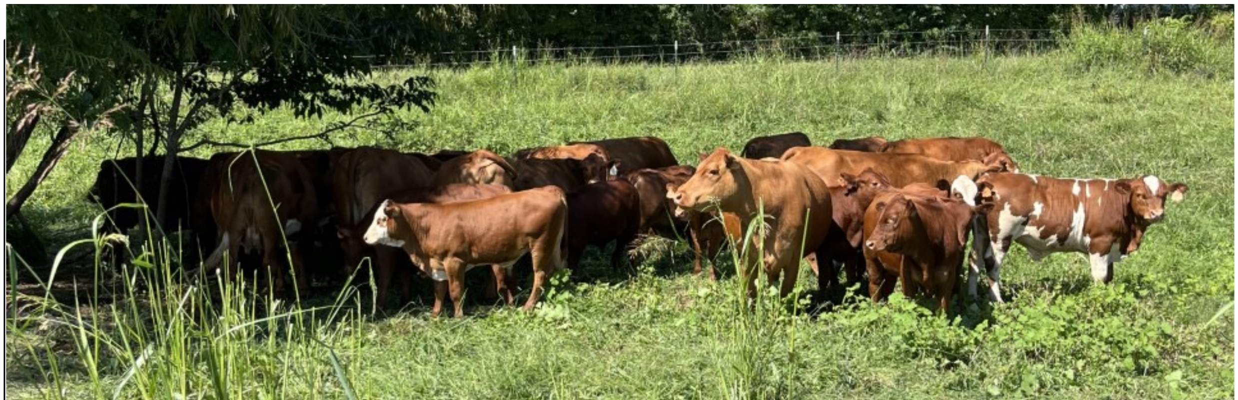

Lesson 6.6.a: Special Tax Rules for Agriculture - Livestock Losses and Weather-Related Sales

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This training provides greater detail on provisions of the tax code that relate to loss of livestock or weather-related sales of livestock.

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Legal Disclaimer

This presentation is intended to provide general information on agricultural income tax issues and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State laws vary and no attempt is made to discuss state specific laws. For advice about how these issues might apply to your individual situation, consult an attorney.

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This project and materials created by Poppy Davis as part of the LL.M. Program in Agricultural and Food Law at the University of Arkansas School of Law is part of the Agricultural Financial, Tax and Asset Protection program.

Program Overview

1. Filing: Federal Income Tax Filing Requirements
2. Records: Recordkeeping Requirements
3. Taxes: Individual Federal Income Tax Return
4. Entities: Business Entities and Federal Tax
5. Agricultural Income: Special Rules
6. **Special Tax Rules for Agriculture** <- We are here.

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There were five lessons previously in this series.

The s[illegible]ining covers special tax rules for agriculture.

Lesson 6
Overview - Special Tax Rules for Agriculture

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Special USDA Programs for Livestock-Related Losses

There are special USDA programs to make payments to livestock producers for losses due to disease, bad weather and fire:

- Livestock Forage Disaster Program (LFP)
- The Livestock Indemnity Program (LIP)
- Emergency Assistance for Livestock, Honeybees, and Farm-Raised Fish (ELAP)
- Congress or the USDA may create additional programs for livestock producers.
- Payments from these programs are generally taxable unless Congress specifically excludes the payments from taxation.

Bees and farmed-fish are livestock for purposes of USDA livestock programs.

The Livestock Forage Disaster Program (LFP) pays producers who have lost access to grazing or forage due to drought or fire.

The Livestock Indemnity Program (LIP) pays producers for livestock deaths caused by adverse weather or predation by reintroduced predators or those protected by federal law, such as bears, wolves, and avian predators.

The Emergency Assistance for Livestock, Honeybees, and Farm-Raised Fish Program (ELAP) pays producers to compensate for losses due to disease as well as adverse weather, and wildfires.

See also Lesson 6.1 for more on taxation of payments from the USDA.

Weather-Related Sales of Livestock

Weather-related events lead to:

- Loss of pasture or forage,
- Loss of feed supply,
- Loss of water supply

Causing taxpayer to sell animals they would have otherwise kept.

The rest of this lesson is about the tax treatment of gain when the taxpayer sells livestock due to weather-related events such as loss of pasture, forage, or supply of feed.

Weather-Related Sales of Livestock

Typical sales year: Sell two breeding cows

Drought year: Sell six breeding cows

Election is available for the income from the four additional sales.

The election is available for sales in excess of the amounts of livestock the taxpayer would have normally sold if the adverse weather conditions had not occurred.

So, if you would typically sell two breeding cows a year but due to drought you sell six, you may make the election with respect to the four sold due to drought.

Weather-Related Sales of Livestock

There are three different options for taxpayers to delay paying tax on the net proceeds from weather-related sales of livestock:

- A one-year delay available for all types of livestock if the sale is due to events declared as a federally designated disaster
- A 2-year delay available only for draft, and dairy animals or breeding animals other than poultry
- A 4-year delay available only for draft, and dairy animals or breeding animals other than poultry if the sale is due to events declared as a federally designated disaster

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These options are all elections to defer recognition of income from the year in which it is received to a future year.

Tax preparers will talk about "deferring income" or "deferring gain" from the year the income was received to a future year.

When you report the income in a future year, a tax preparer would say you are "recognizing the income" or "recognizing the gain."

One-year delay for all types of livestock if related to a federally designated disaster area

To make the election attach a statement

1. **IRC section 451(e) Election**
2. Federal disaster declaration
3. Relationship between disaster and sale
4. Number of animals sold in each of the three prior years
5. Number of animals you would have sold
6. Total number of animals actually sold
7. Number of animals sold due to disaster
8. Deferral calculation

To make the election to delay reporting income from sales of livestock due to the effects of a federally designated disaster you must attach a statement to the tax retur[illegible]vers the year in which the sales took place

1. State that the taxpayer is making an election under **Internal Revenue Code section 451(e).**
2. Refer to the date and area of the federal disaster declaration.
3. Explain why the disaster caused you to sell the animals sooner than you otherwise would have.
4. Provide the number of animals sold in each of the three prior years.
5. Provide the number of animals you would have sold in the tax year if the disaster had not occurred.
6. Provide the total number of animals you actually sold in the tax year.
7. Provide the number of animals you sold during the tax year due to disaster.
8. Provide a calculation showing the amount of income you elect to report in the following tax year (rather than the current tax year.)

Two or Four Year Delay for Weather-Related Sales of Certain Livestock

Special rules apply for:

1. Livestock other than poultry
2. Treated as assets for tax purposes
3. Sold in response to a weather-related event

There are special rules for livestock sales if:
1. The sale is for livestock other than poultry.
2. The livestock is not usually held for sale, but instead held as working animals or used for breeding, or dairy.
3. The livestock is sold in response to a weatherrelated event such as drought or flood and the number of livestock sold is greater than the number that would normally have been sold if the weather event had not occurred.

Usual Tax Treatment of Sales of Livestock Not Held for Sale

- Livestock not held for sale must be treated as depreciable assets for tax purposes.
- When a depreciable asset is sold, the taxpayer recognizes a gain or loss equal to the sales price less the tax basis.
- The gain or loss is recognized in the tax year covering the sale.

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A depreciable asset has a tax basis generally equal to the purchase cost less all depreciation deductions taken.

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Livestock born and raised on the farm or ranch will generally have a tax basis of zero.

Livestock received as a gift will have a basis equal to the basis of the person who made the gift.

Livestock received as an inheritance will have a basis equal to the fair market value of the livestock at the date of death of the former owner.

Special Rule: Defer Gain by Reinvesting in Qualified Replacement Property

- A taxpayer may elect not to be taxed on this type of gain in the year of the sale.
- Taxpayer must replace with similar property within 2 years, or within 4 years for a federal disaster.
- Taxpayer must reduce their basis in the replacement property by the amount of gain that would have been recognized in the year of sale.
- Reduced basis results in:
  - reduced depreciation expense
  - increased gain upon sale

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If livestock not held for sale are sold in response to adverse conditions created by weather (typically loss of feed, water or forage) the taxpayer may elect not to be taxed on the gain in the year of the sale.

This election requires the taxpayer to replace the property with similar property within two years, or if the weather-related event was a federal disaster within four years.

The gain that would have been taxable in the year of the sale is taxed in future years by reducing the basis of the replacement property.

The basis of the new replacement property is decreased by the amount of gain that would have been recognized in the year of the sale.

The taxpayer's depreciation deduction for the replacement property is decreased by the gain not reported in the sale year.

When the taxpayer sells the replacement property the gain on the sale is calculated including the reduced basis due to the deferred gain from the original sale.

For more information

- See Pub 225 and RuralTax.org for information on the tax rules for weather-related sales of livestock and on how to make the election.

The purpose of this lesson is to make you aware of this option.
You will need additional information regarding IRC 1033 and the assistance of a qualified tax preparer in order to make the election.

Questions?

Thank you!

How do I learn more about federal income taxes and my farm or ranch?

- There are previous lessons in this series.
- For each lesson there is a short set of questions you can answer to help you decide if the training will be useful to you.
- You can access the questions and the trainings here:
- https://law.uark.edu/academics/llm-food-ag/llm-projects-agftap.php
- Additional project resources are available here: https://agftap.org

How do I learn more about federal income taxes and my farm or ranch?

IRS Publication 225, The Farmers Tax Guide

RuralTax.org

IRS website and publications

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