



### One-year deferral rule

Farm and ranch taxpayers on the cash method of accounting who are forced because of drought or (for sales and exchanges after December 31, 1996) other weather-related conditions to dispose of livestock are able to defer reporting the gain until the following taxable year. Deferral of income is limited to sales in excess of “usual business practices.”

### Eligibility requirements

To be eligible for deferral, the taxpayer’s principal business must be farming. On this point, there is a very helpful IRS ruling. Under the facts of the ruling, a rancher grossing an average of \$121,000 per year and earning \$65,000 per year from a full-time off-farm job was determined to have farming as their principal business. The rancher devoted 750 to 1,000 hours per year to the ranch and the rancher’s spouse contributed about 300 hours.

Also, the drought (or other weather-related condition) must have resulted in the farmer’s area being designated for assistance by the federal government.

**Note:** The livestock need not be raised or sold in a drought or weather-related area. However, the sale must occur solely on account of conditions in the designated area which affected the water, grazing or other requirements of the livestock so as to necessitate the sale. Also, the livestock may be sold before the disaster designation if they are sold because of the disaster. Any designation of assistance by a federal agency is acceptable for this purpose including FSA or SBA. The taxpayer must establish that, under the taxpayer’s usual business practice, the sale or exchange would not have occurred but for the weather conditions; and the conditions must have resulted in the area being designated for assistance by the federal government.

### Making the election

The election is made by attaching a statement to the income tax return or on an amended return that is made during the replacement period for livestock under I.R.C. §1033(e) if I.R.C. would apply to a sale or exchange of the livestock. This means that the

election can be made within the four-year period (if the four-year period would apply), or the two-year period.

**Note:** This is a change in the law made by the Jobs Bill of 2004. The provision is applicable to any tax year with respect to which the due date (without regard to extensions) for the return is after December 31, 2002. Prior to the amendment (or if the amendment does not otherwise apply), the election had to be made within the time for filing the return including extensions. Thus, the election could not be made on a late-filed return.

The election must contain:

- A declaration that the election is being made.
- Evidence of the existence of weather-related conditions which forced the early sale or exchange of the livestock and the date, if known, on which the area was designated as eligible for federal assistance as a result of the conditions.
- A statement explaining the relationship of the area to the taxpayer’s early sale or exchange of the livestock.
- The total number of animals sold in each of the three preceding years.
- The number of animals which would have been sold in the taxable year had the taxpayer followed its normal business practice.
- The total number of animals sold and the number sold on account of weather-related conditions during the taxable year.
- A computation of the amount of income to be deferred.

**Note:** To arrive at the amount of income deferred, the total amount of income from the sale or exchange of livestock in a classification during the taxable year is to be divided by the total number of all livestock sold in that classification. The result is then multiplied by the excess number of livestock sold on account of weather in that classification. A taxpayer who has made an election to defer the taxation of gain from the sale of livestock because of weather-related conditions has been allowed to later revoke the election and make an election with

the consent of the Commissioner to defer income by reinvestment under I.R.C. §1033(e).

**Note:** To revoke, it may be necessary to file a letter ruling request or request a determination letter from the IRS.

**Observation:** The National Office of IRS does not issue letter rulings on the replacement of involuntarily converted property, whether or not property has been replaced, if the taxpayer has already filed a return for the tax year in which the property was converted. But the IRS may issue a determination letter in such a situation.

#### **Other filing rules**

Another statement is to be attached to the tax return for the year in which replacement property is acquired. The statement should contain detailed information on the replacement property and a computation of tax basis allocation.

An amended return (Form 1040X) must be filed for the tax year of the gain if replacement property is not acquired within the replacement period. Additionally, if replacement property is acquired, but at a cost less than the amount received from the involuntary conversion, that portion (the difference) of the postponed gain must be reported as taxable gain on a Form 1040X.