

Note: The replacement of the livestock is to be reported on the tax returns of the following years. If reinvestment does not actually occur or there is not a full reinvestment, the tax return for the year of the weather-related conditions must be amended to report additional income in an amount equal to the amount that was not reinvested.

One-year Deferral Treatment

Under another provision, if a livestock owner on the cash method of accounting is forced because of drought or other weather-related condition to dispose of excess livestock, the owner can elect to have the gain on sale be deferred until the following taxable year.

Note: The deferral provision only applies to the excess livestock sold during the tax year at issue beyond what the livestock owner would have normally sold. In addition, the area must be declared a disaster area, but the livestock need not be raised or sold in the disaster area.

To be eligible for deferral, the taxpayer's principal business must be farming. But off-farm income is permissible. For example, the IRS has stated in one private letter ruling that a rancher with \$121,000 for the tax year in gross income from ranching, and an additional \$65,000 a year off-farm income, was still deemed to have a principal business of ranching. The rancher devoted 750 to 1,000 hours per year to the ranch, and his wife contributed about 300 hours.

A separate election form must be attached to the return, which must be filed on or before the due date of the return and must contain the following:

- Denote that an election is being made under I.R.C. §451(e);
- Show evidence of the weather-related conditions that forced the early sale, including the date the area was designated as eligible for federal assistance as a disaster area;

- An explanation of the relationship between the weather-related condition and the reason for the sale;
- The total number of animals sold in each of the three preceding years;
- The total number of animals that would have been sold under normal conditions;
- The total number of animals sold during the year and the number sold because of the weather-related conditions; and
- The amount to be deferred to the following year.

Deferral of income is limited to sales in excess of "usual business practices." Thus, deferral is only available for the gain attributable to the excess number of livestock sold on account of the drought or weather-related condition over the number of livestock that the owner would normally sell during the tax year. Also, an election for one-year deferral is valid if made during the applicable replacement period for the livestock under I.R.C. § 1033(e). Similarly, a taxpayer can revoke a deferral election in favor of involuntary conversion treatment, but the converse is not possible.

Note: The deferral provision applies to all livestock held for resale (raised or feeders), as well as livestock used for draft, breeding, dairy or sporting purposes and livestock held for less than two years (cattle and horses) and less than one year for other livestock.

* This Information File is an excerpt from the Center for Ag Law and Taxation (CALT) article on Tax and Legal Issues Associated with the 2012 Drought, www.calt.iastate.edu/cropdrought.html. Visit the CALT website, www.calt.iastate.edu/, for more information and updates on tax related issues concerning weather-related livestock sales, the ability to defer crop insurance proceeds, and the inability to fill forward grain contracts due to lack of crop. Footnotes are not included.