Cooperative Extension System

Cattle Producer's Library

Cow-Calf Section CL1180

Tax Implications of Drought Sales of Livestock

Alan E. Baquet, Extension Farm Management Specialist
Montana State University

Drought Sales

Livestock producers who sell cattle because of drought conditions may receive special consideration for income tax purposes. Producers may elect to postpone for 1 year reporting the proceeds from a sale of livestock if the sale was caused by drought conditions. This election applies to all livestock held for sale, whether raised or purchased for resale. It also applies to livestock used for draft, breeding, dairy, or sporting purposes and held less than 2 years in the case of cattle and horses, or less than 1 year in the case of other livestock.

If, because of drought conditions, producers sell more animals than they would have sold had they followed their normal business practices, they may elect to include the proceeds from the sale of the additional animals in next year's income instead of this year's income. This is an alternative only if the following conditions are met:

1. Your principal business is farming.
2. You use the cash method of accounting.
3. You can show that under your usual business practices the sale would not have occurred this year except for the drought.
4. The drought has resulted in an area being designated as eligible for assistance by the federal government.

Sales made before the area became eligible for federal assistance still qualify as long as the drought that caused the sale also caused the area to be designated as eligible for federal assistance. The livestock sold as a result of drought conditions do not have to be raised in a drought area, and the sale does not have to take place in a drought area to qualify for this postponement. However, the sale must occur solely because of drought conditions that affected the water, grazing, or other requirements of the livestock to the extent that the sale became necessary. The amount of income that can be postponed must be determined based on the producer's usual business practices. The election to postpone income must be made separately for each broad class of animals; for example, hogs, sheep, or cattle. The producer must also figure separately the amount to be postponed for each class of animals. The amount that can be postponed is the average gross income per head for each class of animal times the excess number of animals sold. In making the election, the producer must attach specific information to the tax return in the year of the sale.

Involuntary Conversion

When livestock held for draft, breeding, or dairy purposes are sold or exchanged solely because of drought, their disposition is treated as an involuntary conversion. Only livestock sold in excess of the number normally sold under usual business practices in the absence of drought are considered involuntary conversions. Producers can choose to postpone reporting the gain from these excess sales if they acquire replacement property that is similar or related in service for use to the original property within a specific replacement period. The replacement period ends 2 years after the close of the first year in which any part of the gain is realized.

When livestock held for draft, breeding, or dairy purposes are sold or exchanged because of drought, and you choose to postpone the gain, your return for the tax year in which you first realize any of the gain should contain the following information:

1. Evidence of the drought conditions that forced the sale or exchange of the livestock.
2. The gain realized on the sale or exchange.
3. Number and kind of livestock sold or exchanged.
4. Number of livestock of each kind that you would have sold or exchanged under your usual business practice in the absence of the drought.

The return for the year in which the livestock are replaced should contain information showing:

1. Date replacement livestock was purchased.
2. Cost of the replacement livestock.
3. Number and kind of the replacement livestock.

Involuntary conversion treatment applies only to livestock that is held for draft, breeding, or dairy purposes. In these cases, any gain realized must be treated according to the rules identified earlier under drought sales. Producers should consult their tax accountants for information on their specific situations or refer to IRS publication 225 “The Farmers Tax Guide.” This publication is available through local Cooperative Extension System offices.

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