PERSPECTIVES

Market Advisor

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Forced sales have tax implications

Dry weather conditions in parts of the northern Plains during the last several years and continuing this year have caused forced liquidation of breeding livestock and early sales of market livestock.

Forced sales of livestock

Livestock producers who have been forced to sell livestock or who are considering selling because of abnormally dry conditions may receive special consideration for federal income tax reporting purposes. Furthermore, a number of tax law changes important to livestock producers became effective through the American Jobs Creation Act (HR 4520) in October 2004.

Producers considering marketing livestock at abnormal times due to dry conditions should consult with their tax advisor.

Income tax reporting for forced sales of livestock because of drought or other weather-related conditions may be handled in two different ways, according to Internal Revenue Service (IRS) guidelines.

The first provision applies to all types of livestock and allows postponement for reporting income from forced sales for a year. For example, the normal business practice for a cattle producer may be to background calves after fall weaning and market them the next February. If the calves are marketed at weaning in October due to drought conditions and lack of feed supplies, the income may be postponed until the next year. Only sales in excess of normal (normal is usually defined as the number sold in each of the last three years) qualify for the deferral.

The drought must have caused an area to be designated as eligible for assistance by the federal government. However, the livestock do not have to be raised or sold in the exact designated area, such as a particular county, but only a nearby area.

The other IRS provision applies to the forced sale of draft, breeding and dairy animals, but excludes poultry. If these animals are sold due to a drought, the sale may be treated as an involuntary conversion.

Producers can choose to postpone reporting the capital gain from forced sales as long as similar animals are repurchased in the future. For example, if an Angus cattle producer normally markets 25 cull cows a year, but in a drought year is forced to sell 50 head, only the additional 25 head that will be replaced later are eligible for the involuntary conversion.

Tax law provisions

Two important provisions were included in the 2004 revised tax law. First, the replacement period has been extended from two to four years and is retroactive back to the 2002 tax year.

Second, if it is not practical for the producer to reinvest in the same class of livestock, other property (except real property) used for farming or ranching qualifies as replacement property.

The IRS tax code is complex, so livestock producers considering marketing livestock at abnormal times due to dry conditions should consult with their tax advisor. Other tax management tools, such as income averaging, also should be considered.

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