Drought Related Livestock Sales and Tax Reporting Options

Livestock producers are making hard decisions this summer and fall as widespread drought conditions limit pasture, hay, and, in some places, water availability across the southern and western states. Drought losses can result in additional costs for purchased hay (for those who can find a hay source), selling calves early, retaining fewer replacement heifers, or culling cows to reduce pressure on pasture and rangeland. Drought disaster programs are available to help offset some of the additional costs. For example, the Emergency Assistance for Livestock, Honey Bees and Farm-Raised Fish (ELAP) program can help offset the added cost of transporting hay from greater distances this year. Forage management and supplementation can also stretch available grazing to reduce the need for winter hay feeding in some areas. However, in many cases, producers will be reducing herd sizes through additional cattle sales.

Drought related costs and losses will be reflected on 2022 tax returns for many producers across the country. Understanding how those losses must be reported come tax season and what documentation to retain will aid in properly reporting expenses and program payments. Drought related farm expenses and payments from drought disaster programs are fairly straightforward. For example, if a producer purchases hay in 2022 sourced from farms in states at a greater distance than previous years, they may be eligible for the ELAP transportation cost offset mentioned previously. The producer would report the cost of hay and hauling as farm expenses. The ELAP disaster payment for excess transportation cost would be reported as income. For more information on USDA disaster program documentation requirements, see factsheet: https://extension.okstate.edu/fact-sheets/usda-program-recordkeeping-requirements.html

Cattle sales will also be reported on tax returns, but these decisions are a little more complicated. Gains from breeding, dairy or draft cattle sales in excess of normal due to drought may be deferred for up to two years, as long as the dollar value of the cattle are replaced within those two years. Record keeping is critical. The producer can only defer cattle sales that are above what would typically be sold under normal production conditions. Two tax provisions exist to avoid the adverse tax consequences of selling more animals than normal due to weather related conditions. One applies only to breeding, dairy and draft animals that will be replaced. The second applies to market animals where the income from the additional animals sold are reported in the year that they would have normally been marketed.

Consider an example for breeding animals: Over the past 3 years, my cattle operation sold 30 calves weighing 650 pounds and 4 cull cows as an annual average. Due to drought in 2022, I sell 5 replacement heifers I would ordinarily have retained and 10 cows (6 more than the average) for $10,000. I can defer reporting the $10,000 of income from the excess animal sales (the 5 replacement heifers and the 6 cows) by electing to replace those sold by buying at least $10,000 of replacement breeding animals by December 31, 2024. If I do not spend at least $10,000 on replacement animals, I must amend the 2022 return and report the difference as income in that year. Should my county or a contiguous county be declared a federal disaster area, the replacement period is extended to 4 years and the animals will not have to be replaced until the end of 2026. The replacement animals must also be of the same type and purpose of the animals sold (dairy animals for dairy animals or breeding for breeding). This tax provision is under Internal Revenue Code Section 1033(e).

Now consider an example for the sale of any livestock (other than poultry) due to weather related conditions, and this time the county I raise cattle in is declared a federal disaster area (which is a requirement for this provision). Using the same facts as the prior example, I sold 6 more cows and 5 replacement heifers plus 15 head of calves (that would have normally been sold in 2023) for $20,000. Combined, this is more livestock than what would have normally been sold had the drought conditions not existed. This tax law provision allows me to elect to report the $20,000 of income in 2023 instead bunching this excess income in 2022. This tax provision is under Internal Revenue Code Section 453(g).

Documentation is critical for all drought related losses. Specifically for your taxes keep the following in your tax records:

- Evidence of the weather-related conditions that forced the sale or exchange of animals.
- Number and kind of livestock sold or exchanged.
- Number of livestock of each kind that would have been sold or exchanged under normal business circumstances (generally, the average number of animals sold over the three preceding years).
- The amount of gain realized on the sale or exchange.
- The amount of income to be postponed

It will be important to discuss the application of these tax provisions with your income tax advisor. Sources of drought information include the Drought Monitor Maps which indicate drought intensity by state and region. In addition, USDA reports which counties are currently considered drought disaster areas and are eligible to receive federal disaster programs, and disaster declarations generally are available from State and Federal government websites and stakeholder announcements. Tax season seems like it is far off on the horizon still, but better understanding how drought related losses will be reported may aid in documentation of losses today.

For more information see the Rural Tax Center factsheet http://ruraltax.org/files-ou/RTE_2021-05_Weather_Related_Sales_of_Livestock.pdf

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