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## Extension Range Livestock Economist



**NM**  
STATE

**Range Improvement Task Force**

Cooperative Extension Service / Agricultural Experiment Station  
College of Agricultural, Consumer and Environmental Sciences

# ***Livestock Considerations in Times of Drought***

- Livestock liquidation
- Rangeland health
- Replacement rates
- Genetic considerations



# ***Drought is defined as?***

Under a new USDA initiative, severe drought disasters are declared when any portion of a county meets the D2 (Drought-Severe) intensity for eight or more consecutive weeks or D3 (Drought-Extreme) or higher at any time during the growing season. This new process has cut the average time it takes to turn around a disaster request from 85 days down to 29.



# ***Tax Considerations in Times of Drought***

- Tax consequences
- Each dollar received may be taxable unless the tax codes states otherwise
- Each business related expense is deductible from income as stated by tax code
- This is not always common wisdom but it is the law
- Tax considerations are not always and probably should not be the primary concern of the producer



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# ***Drought Forced Livestock Sales***

- Livestock must have been sold due to the following:
- Sales must exceed normal cull rates
- Shortage of Water
- Shortage of Feed
- Other Drought Forced Factors



# ***New Mexico Status***

- Each of the counties in New Mexico qualify
- Producers may choose from three primary options when identifying their personal tax management strategy for the current tax year.



# ***Producer Options***

- Retire Current Tax Obligation in Current Year
- Tax Treatment #1: Code 451(e) ***The election to postpone reporting of taxable gain on the additional sales of ANY livestock for one year.***
- Tax Treatment #2: Code 1033(e): ***The election to postpone and altogether avoid paying taxes on the gain from the sale of breeding animals if the are replaced within a specified time period.***

# ***Tax Treatment IRC Code 451 (e)***

- Principal business must be agriculture
- Must be declared eligible for federal assistance
- Must utilize the cash method of accounting
- Included in your tax return you must include the reason and the state that your option is based under IRC 451(e)
- A three-year average is necessary to substantiate sales are above normal operating levels
- Your county or neighboring county must be designated as being eligible for disaster assistance
- Sales from normal operations are still reported for the current year

# ***Tax Treatment #1 (Example)***

- Average sales; 100 cows, calves and bulls
- Drought year sales; 150 cows, calves and bulls
- Tax Treatment #1 is not class specific, thus, there have been an additional 50 animals sold this year due to drought conditions
- Income from the 100 animals is;  $\$100,000/100 = \$1,000$  per
- Income from the 150 animals is:  $\$150,000/100 = \$1,500$  per
- The deferred sales are then  $\$50,000$  or  $\$1,000$  per animal

# Tax Treatment IRC Code 451(e)

Advantages	Disadvantages
<p>All livestock classes</p> <p>Livestock may be re-purchased and depreciated to reduce income gain burden</p> <p>Do not have to re-invest in livestock but also depreciable equipment</p>	<p>Defers income for only one year</p>



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# ***Tax Treatment IRC Code 1033(e)***

- Same rules apply as in IRC 451(e) in addition:
- Either 2 or 4 year election on involuntary conversion must be made
- Election will be for 2 years if area does not have a federal disaster declaration
- Election can be for up to 4 years if a federal declaration does exist for the area
- Drought-induced sales must exceed three-year average
- Only breeding livestock qualify
- Evidence of a drought must be present but not your county does not need to be designated a disaster area
- All livestock sold must be accounted for by classification

# ***Tax Treatment IRC Code 1033(e)***

- Only breeding livestock qualify
- An equal or greater number of livestock must be purchased within two years of the tax year of forced sales
- Replacement livestock must be used for the same purpose
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# ***Tax Treatment IRC 1033(e) (Example)***

- Assume breeding livestock is raised due to basis considerations and that classification of livestock is required
- Normal 3-year average sales of 50 calves, 15 cows and 2 bulls.
- Drought year sales; 45 cows, 4 bulls
- Additional sales of 30 cows and 2 bulls are then able to be considered in Tax Treatment #2.
- Cows sold for \$1,000 and bulls for \$1,300. The adjustment would be; \$32,600

# ***Tax Treatment IRC 1033(e)***

Advantages	Disadvantages
<p>Defers investment 2-4 years</p> <p>Does not need to be disaster area</p> <p>Election may be made for up to 2 years after the taxable year the sale was made</p>	<p>Only breeding livestock</p> <p>Replacement investment must be for same purpose</p> <p>Must purchase not raise replacements</p> <p>Capital gains not re-invested in same class of livestock is subject to capital gains taxation</p>

# ***Producer Possibilities***

- Allows producers to employ these tools to reposition themselves for the future
- These tools should be coupled with others for a better consideration of future financial stability
- Drought year sales; 45 cows, 4 bulls
- Additional sales of 30 cows and 2 bulls are then able to be considered in Tax Treatment #2.
- Cows sold for \$1,000 and bulls for \$1,300. The adjustment would be; \$32,600

# ***Conclusion***

- Tax planning and record keeping are essential to sustaining operations
- Visit with your tax professional to verify which approach is most advantageous to your individual operation.
- Remember that it is our obligation to ourselves to understand tax policy to legally reduce our tax liability to it's lowest financial impact.