farmdoc DAILY

Department of Agricultural and Consumer Economics, University of Illinois Urbana-Champaign

Illinois Farm Disaster Areas

Gary Hoff

Tax School and Department of Agricultural and Consumer Economics
University of Illinois

September 19, 2012

***farmdoc daily* (2):182**

Recommended citation format: Hoff, G. "Illinois Farm Disaster Areas." *farmdoc daily* (2):182, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, September 19, 2012 .

Permalink: http://farmdocdaily.illinois.edu/2012/09/illinois-farm-disaster-areas.html

U.S. Secretary of Agriculture Tom Vilsack has declared all but four Illinois counties as disaster areas due to the 2012 drought. Those counties not in the disaster area are Cook, DuPage, Kane, and Will. When thinking about a disaster, a casualty loss deduction normally comes to mind. Unfortunately, this is not the case for a drought. Even though the consequences of a drought can be devastating, normally it is not considered a disaster eligible for a casualty loss deduction.

This discussion only applies to disaster losses. It **does not** pertain to the crop insurance proceeds many **grain farmers** will receive this year. There are special rules for deferral of crop insurance proceeds that were discussed in the July 27, 2012 edition of farmdoc Daily.

The IRS defines a casualty as the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual. A sudden event is one that is swift, not gradual or progressive. An unexpected event is one that is ordinarily unanticipated and unintended. An unusual event is one that is not a day-to-day occurrence and that is not typical of the activity involved.[1] Therefore, a drought does not qualify for any special deductions. The IRS might make an exception if the drought only occurs once every hundred years, but that is not the case for the 2012 drought.

The IRS has two different code sections dealing with weather-related disasters and livestock. IRC Sec. 451(e) allows farmers to defer recognizing the gain from the sale of livestock sold due to the drought for one year. Therefore, livestock sold in 2012 are taxed in 2013 if the election is made. To qualify for the deferral, the livestock must be in a declared disaster area and the weather must be the reason for the sale. However, only livestock sold in excess of the normal numbers may be deferred.

If these animals are not replaced, the farmer may be able to report the sales in the following year, 2013. The following rules must be met:

1. The farmer's principal trade or business must be farming.
2. They must use the cash method of accounting.
3. The weather-related condition caused an area to be designated as eligible for assistance by the federal government.

Animals sold before the disaster declaration was made, qualify if the cause of the sale was for the same reason the federal declaration was made. The declaration can be made by the President, the Department of Agriculture (or any of its agencies) or by federal departments or agencies.

IRC Sec. 1033(e) is a second special rule allowing cash-method farmers to elect to defer income received from the forced sale of livestock due to drought, flood or weather-related conditions. If livestock held for draft or breeding purposes are sold because of drought, flood or other weather-related conditions, the sale is treated as an involuntary conversion. This classification allows for special tax benefits. However, this special rule is similar to IRC Sec. 451(e) in that it only applies to any excess livestock sold. For example, Tom Farmer normally sells 30 cull dairy cows each year. However, he sold 70 cows in 2012 because he did not have enough silage to feed the cattle through the winter. The special rules only apply to the 40 (70 – 30) cattle sold in excess of his normal sales.

Suppose this is Tom's first year of dairying. Because he has no past history of cattle sales, he can estimate what the normal sales would be by using the customary culling rate for the dairy industry. If Tom has 100 cows, he can use 25% as his normal culling rate. Therefore, he can use the special rules on 45 cows. Interestingly, even if Tom's farm was not in a disaster county, he can still use the special rules if the sale was the result of a weather-related condition that affected the water, grazing, or other requirements of the livestock.

The special rules allow Tom to postpone the gain on the sale of the extra animals. To calculate the gain on the excess cattle, Tom will take the total sale proceeds of all cows sold and divide it by the number of head sold. He will then multiple this amount by the number of excess animals sold. In Tom's case, assume he sold the 70 cows for $91,000, his average price would be $1,300 ($91,000 ? 70) per head. Therefore, Tom can postpone the gain on $58,500 (45 ? $1,300). This assumes the cows were raised and do not have any basis.

If Tom chooses to postpone reporting the gain, he must show the following information on a statement he attaches to his tax return.

1. Evidence of the weather-related conditions that forced the sale or exchange of the livestock.
2. The gain realized on the sale or exchange.
3. The number and kind of livestock sold or exchanged.
4. The number of livestock of each kind he would have sold or exchanged under his usual business practices.

The special rules only allow Tom to postpone the gain. Because the cows are sold in an area eligible for federal assistance, he can use the proceeds to purchase replacement cows. Dairy cows can only replace dairy cows and beef cows can only replace beef cows. The cows must be purchased within two years from the close of the first tax year in which Tom realizes income from the cattle sales. In Tom's case, with the sale being in 2012, the close of the year is December 31, 2012 so he would have to purchase the replacement cows by December 31, 2014. If Tom does not spend $58,500 for replacement cows, he will report the excess income on an amended 2012 return.

If the disaster area is eligible for federal assistance, the replacement period is four years.

If it is not practical for Tom to reinvest in more dairy cows, the special rules allow Tom to reinvest the money in any farm asset except real estate. This means he can use the proceeds to purchase farm equipment.

In the year of replacement, Tom will show the following information:

1. The dates he purchased the replacement livestock.
2. The cost of the replacement livestock.
3. A description of the replacement property. This includes number and kind for livestock.

If Tom sold the cows because of the drought, he has several options available to him. He must be careful in which option he chooses because some require an irrevocable election.

More information on this topic is available in Publication 225, *Farmers Tax Guide*, at www.irs.gov.

Footnotes

[1]Rev. Rul. 77-490