



# Disaster Recovery

**LSU**  
**AgCenter**  
Research & Extension

## Tax Considerations for Livestock Producers Impacted By 2005 Hurricanes

The livestock sector was dealt a very difficult blow from both Hurricanes Katrina and Rita. While the first images of the storm were that of lost livestock, producers have faced several other issues as they attempt to return their operations to some form of normalcy. Problems such as damaged facilities and infrastructure and the forced liquidation of cattle have been as difficult as losing livestock.

While tax issues are generally not initially considered in the aftermath of the storms, there may be several areas in which tax regulations and programs can help reduce some of the financial burdens caused by the storms. Producers may be able to get some tax relief for the livestock losses they experienced as well as infrastructure losses. In addition, producers must consider the tax implications of any government assistance received as well as income generated through the forced liquidation. The following will provide a brief description of these tax considerations along with the regulations that govern them.

### Casualty Losses

A casualty is defined as the damage, destruction or loss of property resulting from an identifiable event that is sudden, unexpected or unusual. Deductible casualty losses can result from a number of different causes, including:

- Airplane crashes
- Car, truck or farm equipment accidents not resulting from your willful act or willful negligence
- Earthquakes
- Fires
- Floods
- Freezing
- Government-ordered demolition or relocation of a home
- Lightning
- Storms, including hurricanes and tornadoes

The appeal of the casualty loss regulation is that many of the losses associated with the casualty can be deducted from a producer's income to lessen the tax burden. The following is a list of some of the losses associated with livestock producers that can and cannot be deducted.

**Livestock purchased for resale:** Livestock purchased for resale are deductible if income is reported using the cash method. If income is reported using the accrual method, casualty losses on livestock purchased for resale are taken by omitting the item from the closing inventory for the year of the loss.

**Livestock raised for sale:** In general, casualty losses on livestock raised for sale are not deductible for producers who report income using the cash method. The costs of raising the livestock would have already been deducted as farm expenses. For those producers who report income using the accrual method, casualty losses of raised livestock are deductible only if they were included in inventory at the beginning of the tax year. The deduction would be achieved by omitting the item from the closing inventory for the year of the loss.

**Income Loss:** A loss of future income is not deductible.

**Property used in farming:** Losses of property used in your farm business generally result in deductible losses. For example, if the storms destroyed a barn, that loss would generally be a deductible loss. Repairs and replacement to fencing, however, would not constitute a casualty loss. Those expenses would be handled in the same manner as other production expenses.

**Purchased breeding animals:** As with the loss of the barn, loss of breeding animals would generally result in a deductible loss.

**Raised breeding animals:** Generally losses of raised breeding animals are not deductible because there is no basis<sup>1</sup> in the animal; however, a loss may be deducted for raised breeding animals if 1) the producer uses inventories to determine income and included the raised breeding animals in the inventory,

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<sup>1</sup> The basis of property (including breeding livestock) is generally viewed as the price paid for the property.

or 2) the producer capitalized the expenses associated with the animals under the uniform capitalization rules and therefore have a tax basis in the animals. For those raised animals that are included in inventory, the last inventory value is its basis. The loss deduction is taken by decreasing ending inventory by the amount that was included in the inventory for the animal.

**Figuring a Casualty Loss**

Determining a casualty loss examines the adjusted basis in the property, the fair market value of the property before and after the loss, and any insurance or other reimbursement received for the property. The casualty loss is based on the lesser of the adjusted basis and the change in the fair market value.

The adjusted basis in the property is the basis (usually cost) of the property increased or decreased by various events. For example, annual depreciation would reduce the original basis level.

Let's look at an example: Assume that you had a bull you originally purchased for \$5,000. Your original basis in the animal was \$5,000. Also, assume that after a few years of depreciation, your adjusted basis in the animal was \$3,000. Assume that bull had a fair market value of \$4,000 before the storm and that you lost the bull and had \$1,000 in insurance proceeds on the bull. The casualty loss would be calculated as the following:

- 1) Adjusted Basis ..... \$3,000
- 2) Value Prior to Storm ..... \$4,000
- 3) Value After Storm ..... \$0,000
- 4) Change in Value (2 minus 3) \$4,000
- 5) Loss (Lesser of 1 and 4) ..... \$3,000
- 6) Insurance Proceeds ..... \$1,000
- 7) Loss less Insurance ..... \$2,000

In this example, since the adjusted basis was less than the change in the fair market value of the bull, the loss was set at the value of the adjusted basis. The loss is then adjusted for the amount of insurance proceeds received for the bull to provide the total deductible casualty loss of \$2,000.

Typically, if a single casualty involves more than one item of property, the loss must be figured on each property separately. The total deductible loss would simply be the sum of the individual property losses. For example, assume that the producer lost a bull and a barn in the storm. The producer would have to calculate his deductible casualty loss for each separately and then add them together to determine the total deductible.

The cost of cleaning up or making repairs after a loss is NOT part of the casualty loss; however, these expenses

can be used to decrease the fair market value of the property if the following are met:

- The repairs are actually made
- The repairs are necessary to bring the property back to its condition before the casualty
- The amount spent for repairs is not excessive
- The repairs fix the damage only
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty

Incidental expenses due to the casualty, such as temporary housing or car rental, are not part of the casualty loss, but can be deducted as a farm business expense if the damaged property is farm property.

**Limits on Casualty Losses**

While there are no regulations specifically limiting the amount of a casualty loss of business property, a casualty loss of personal-use property is typically limited by the \$100 rule and the 10% rule. The \$100 rule states that you must reduce the casualty loss by \$100. The 10% rule states that you must further reduce the casualty loss by 10% of your adjusted gross income (AGI).

For example, assume that you calculated your deductible casualty loss on your home at \$5,000 after making adjustments for insurance proceeds. Also assume that your adjusted gross income was \$60,000. Therefore, applying the \$100 rule and the 10% rule, the casualty loss would be:

- 1) Loss after insurance ..... \$5,000
- 2) Subtract \$100 ..... \$ 100
- 3) Loss after \$100 rule ..... \$4,900
- 4) Subtract 10% of AGI (60,000\*10%)..... \$6,000
- 5) Loss after 10% Rule ..... \$0,000

Therefore, despite a deductible loss, the \$100 and the 10% rule would eliminate the deduction.

An exception to this rule has been made to those people affected by Hurricane Katrina. If the loss arose after August 24, 2005, and was attributable to Hurricane Katrina, the \$100 and the 10% rule does not apply.

**Other Casualty Loss Considerations**

To deduct a casualty loss, you must be able to prove the loss. Therefore, your records must provide the following information:

- The type of casualty (fire, storm, etc.) and when it occurred

- That the loss was a direct result of the casualty
- That you were the owner of the property or, if you leased the property, that you were contractually liable to the owner for the damage
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery

If your deductions, including casualty loss deductions, are higher than your income for the year, you may have a net operating loss (NOL). A net operating loss can be carried back or carried forward and deducted from income in other years.

If, however, the insurance or other reimbursements exceed the estimated loss, you would have a taxable gain. In that case, you would have to report it as income. There are, however, allowances for postponing those gains if the property is replaced in a predetermined time period.

Finally, if you take a casualty loss deduction, you must decrease your basis in the property by the amount of insurance or reimbursement received and by the amount of deductible loss. This would be your new adjusted basis in the property.

### **Weather-related Sales of Livestock**

Another tax issue facing livestock producers is the forced sale of livestock. Producers who were forced to sell more livestock than they normally would have due to the storm may be able to delay reporting that income. Different rules apply if the livestock were breeding or non-breeding animals.

#### ***Sale of Breeding Livestock***

If livestock held for breeding or dairy purposes were sold solely because of the weather event, these sales can be treated as involuntary conversions. Under normal conditions, a producer would have to show the gain from the sale of these animals; however, in an involuntary conversion, the gain can be postponed replacement property similar or related in service or use is purchased within a specified replacement period. Only breeding or dairy animals sold over and above the amount normally sold in a typical year would be eligible.

To postpone reporting all the gain, the cost of your replacement property must be at least as much as the reimbursement you receive. If the cost of replacement is less, you must include the gain in your income up to the amount of the unspent reimbursement.

For the sale or exchange of livestock, the replacement period ends 4 years after the close of the first tax year in which you realize any part of your gain from the sale or exchange.

To postpone the gain due to the involuntary conversion, you must attach a statement to your return on the year you first realize the gain:

- Evidence of the weather-related conditions that forced the sale
  - The gain realized on the sale
  - The number and kind of livestock sold
  - The number of livestock of each kind you would have sold under your usual business practice.
- In addition, during the year the livestock were replaced, you must show on your tax return:
- The dates you bought the replacement property
  - The cost of the replacement property
  - Description of the replacement property (number and kind of the replacement livestock)

If you postpone the gain, but fail to replace the livestock, you must file an amended return for the tax year in which the livestock were sold. You would also have to file an amended return if the cost of replacing the livestock was less than the amount of gain postponed.

#### ***Sale of Non-breeding Livestock***

For non-breeding livestock that were sold because of a weather-related event, producers may be able to postpone that gain until the following tax year. If more livestock was sold than under normal business operations due to the weather-related event, the gain from the sale of those additional animals could be postponed until the next tax year. To do this, the following must be met:

- Your principal trade or business is farming
- You use the cash method of accounting,
- The weather-event caused your area to be designated as eligible for disaster assistance

The amount of the sales that can be postponed is only the amount of livestock sold over and above those normally sold in a year. For example, if you normally sell 50 head of cattle in a year, but are forced to sell 65 head for \$32,500 due to a weather-related event. The average value of the cattle you sold was \$500 per head ( $\$32,500 \div 65$ ). Therefore, you could only postpone the sale of 15 head (the amount over and above your normal sales) and would be able to postpone \$7,500 of the proceeds ( $15 \times \$500$ ) until the next year.

To postpone the gain, you must attach a statement to your return which provides the following:

- A statement that you are postponing the gain under section 451(e) of the Internal Revenue Code
- Evidence of the weather related conditions that forced the early sale of the livestock and the date, if known, when the area was designated a disaster area
- A statement explaining the relationship of the weather-related event to your early sale of livestock
- The number of animals sold in each of the 3 preceding years
- The number of animals you would have sold without the weather event
- The total number of animals sold and the number sold because of the weather event
- A computation of the income to be postponed.

### **Crop Insurance, Disaster Payments and Cost-sharing Programs**

Proceeds received from crop insurance and through government assistance programs generally must be shown as income in the year in which they were received, but there are some regulations that allow producers to postpone reporting those proceeds until the next tax year.

Crop insurance proceeds can be postponed until the following year if the following conditions are met:

- You use a cash method of accounting,
- You receive the crop insurance proceeds in the same year that the crop was damaged, and,
- You can show that under normal business practices you would have included income from the damaged crops in any tax year following the year the damaged occurred.

Feed assistance and payment programs from the U.S. Department of Agriculture, however, must be included in income. This would include any feed donated or sold at below market price owned by the Commodity Credit Corporation. Donations from other sources would not have to be included as income as long as the donating

agency or organization does provide the producer a 1099 Tax Form.

Payments received under a federal cost-sharing program can be excluded from your income if the payment applies to the following:

- It was for an expense that you cannot deduct in a year you pay or incur it (i.e. a capital expense),
- It does not substantially increase your annual income from the property for which it is made, and,
- The Secretary of Agriculture certified that the payment was primarily made for conservation purposes.

If the three items listed are met, you can exclude payments from several conservation programs including the emergency conservation program that many producers utilized to assist in debris cleanup and fence repair following Hurricanes Katrina and Rita.

### **Summary**

There are several tax issues that producers should consider as they continue to attempt to recover from the Hurricanes. While none of these regulations will, by themselves, return everything to normal, they can be a component of producers' overall plan of recovery.

Unfortunately, tax issues are often very complex. Producers interested in taking advantage of these regulations are encouraged to contact their local tax consultant to obtain more detailed information. Producers can also obtain more information regarding these and other tax issues by reviewing the IRS's Publication 225 "Farmers Tax Guide For 2005". This publication can be found online at:

<http://www.irs.gov/pub/irs-pdf/p225.pdf> .

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