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## **TAX RELIEF FOR SALE OF LIVESTOCK DUE TO DROUGHT**

**By Brad Gould, Esq.**

In Notice 2007-80, issued this past Friday, the Secretary of the Treasury extended the four-year period to acquire property similar or related in service or use (“Replacement Property”) under §1033 of the Internal Revenue Code (the “Code”) for livestock sold or exchanged on account of drought. This extension of time applies only to taxpayers who operate in areas that experienced an exceptional, severe, or extreme drought for any week during the prior twelve months. Accordingly, affected taxpayers will have at least one additional year to replace livestock held for draft, breeding, or dairy purposes sold or exchanged solely as a result of drought. If a taxpayer fails to purchase Replacement Property, then any gain from the sale or exchange must be recognized. These provisions, while very beneficial, are highly technical and therefore not always quickly understood.

### **Background**

Pursuant to Code §1033, the gain from proceeds received from property that was compulsorily or involuntarily converted will not be recognized to the extent that the proceeds are used to acquire Replacement Property within two years after the tax year in which the transaction occurred. Generally, property is considered to be compulsorily or involuntarily converted when it is destroyed, stolen, seized, requisitioned or condemned or is sold or exchanged under threat or eminence of condemnation.

However, Code §1033(e) expands the general rule of Code §1033 in two ways. First, §1033(e)(1) concerns the sale or exchange of livestock used for draft, breeding, or dairy purposes (other than poultry). If a taxpayer sells or exchanges an amount of such livestock in excess of the amount that it would have sold in its normal course of business solely as a result of drought, flood, or other weather related conditions, then the sale or exchange of the excess livestock shall be treated as an involuntary conversion. Thus, a farmer who is forced to sell an excessive amount of its livestock to avoid the ravages of drought may be able to defer the gain from the sale if the other requirements of Code §1033 are met.

Second, Code §1033(e)(2)(A) extends the normal two year period to acquire Replacement Property to four years if the drought is in an area eligible for assistance by the federal government. Therefore, a farmer whose livestock was involuntarily converted because of

drought operating in a designated area has four years, instead of two, to acquire Replacement Property.

### **Extension of Replacement Period**

Furthermore, Code §1033(e)(2)(B) allows the Secretary of the Treasury to extend, on a regional basis, the four year replacement period if the weather conditions which resulted in the involuntary conversion of the livestock continued for three or more years. In Notice 2006-82, the IRS provided that due to continuing severe drought conditions, the four-year replacement period will be extended until the end of a farmer's tax year that ends after the farmer's first drought-free year in the region in which it operates. The first drought-free year is the 12-month period that: (1) ends on August 31; (2) ends in or after the last year of the four year replacement period; and (3) does not include any weekly period for which exceptional, severe, or extreme drought was reported in any location of the applicable region. As a result, a farmer has until the end of the farmer's first taxable year ending after the first drought-free year for the applicable region to acquire the Replacement Property.

### **Applicable Regions**

The applicable region with respect to involuntarily converted livestock means the county that brought the conditions leading to the sale or exchange of the livestock and all counties contiguous to the affected county. State borders are irrelevant. Therefore, a contiguous county in another state is part of the applicable region.

Farmers may refer to the U.S. Drought Monitor Maps produced weekly by the National Drought Mitigation Center to determine whether they operate in an affected county. Alternatively, the IRS will publish a list of counties that experienced exceptional, severe, or extreme drought in the 12 month period ending August 31 of each calendar year.

Notice 2006-91, published October 16, 2006, lists 35 states with affected counties. Thirteen Florida counties are included. Notice 2007-80 issued September 28, 2007, lists forty states with affected counties. Sixty Florida counties are included.

### **Conclusion**

Code §1033(e) is a farmer friendly provision can help mitigate some of the costs of drought. However, the provision is very technical in its application. You should consult with your legal and tax advisors to determine if you or your business can benefit from Code §1033.

Members of the Dean Mead agribusiness team are familiar with all aspects of this tax deferral provision and are able to discuss its application with you.