Disaster and Casualty Losses: Related Tax Rules

JC Hobbs – Associate Extension Specialist
Department of Agricultural Economics
Oklahoma State University

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- Informational Material on a variety of Topics but not limited to:
  - Disaster/Weather Losses
  - Treatment of Government Payments
  - Farm Losses and Hobby Rules
  - Self-Employment Taxes
  - Estate and Gift Taxes
  - Like Kind Exchanges
  - Depreciation
  - Etc...

DISASTER TAX ISSUES

PRESENTATION DEVELOPED BY IOWA STATE UNIVERSITY

IMPORTANT INFORMATION

- Information provided is for farmers and ranchers but is also applicable for others who experienced losses due to a weather event.
- Items in *italics* provide information for your tax preparer to use to properly complete the tax return.

OVERVIEW

- Many farmers and ranchers suffered damage and loss in 2024 because of hurricanes.
- This presentation provides an in-depth review of disaster tax provisions, including:
  - the calculation of casualty gains and losses,
  - deferral of gain for involuntary conversions, and
  - the rules for deferring crop insurance, disaster payments, and gain from the sale of livestock.

CASUALTY

- A casualty is damage, destruction, or loss of property caused by an identifiable event that is "sudden, unexpected, or unusual." *[See, e.g., Matheson v. Commissioner, 54 F.2d 537 (2d Cir. 1931)].*
- Casualties include damage, destruction, or loss of property caused by natural disasters such as hurricanes, tornados, floods, derechos, and hail.

CASUALTY

- Determining the tax treatment of a casualty event depends upon many factors, including:
  - Whether the damaged or destroyed property was used in a trade or business or held for the production of income (as opposed to being used for personal use),
  - How much the property had been depreciated,
  - Whether insurance proceeds were received, and
  - Whether damaged property was restored or replaced
- Depending upon the facts and circumstances, taxpayers experiencing damage from a natural disaster may have a casualty loss, a casualty gain, or a tax-deferred involuntary conversion.

BASIS

- In the case of business property or property held for the production of income, the starting point in determining the tax consequences of a casualty is the adjusted basis of the damaged or destroyed property.
- Under I.R.C. § 1012, the adjusted basis is generally the cost of the property minus accumulated depreciation or any I.R.C. § 179 expense that has been taken, plus the value of any improvements.
- I.R.C. § 1016 requires taxpayers to adjust the basis of property for expenses, receipts, losses, or other items properly chargeable to their capital accounts.

BUSINESS CASUALTY LOSS

- A casualty loss deduction is generally allowed for a business casualty loss sustained during the taxable year that is not compensated by insurance or otherwise.
- Under I.R.C. § 165(c), taxpayers may deduct casualty losses incurred in a trade or business or a transaction entered into for profit.
- The calculation of the casualty loss depends upon whether the property is merely damaged or completely destroyed.

PERSONAL CASUALTY LOSSES

From 2018 through 2025, losses on personal use property are only deductible if they arise from a casualty attributable to a federally declared disaster.

This limitation does not apply to losses on income-producing property.

NOTE: This rule will likely be extended beyond 2025 based upon the election results.

LESS THAN TOTAL DESTRUCTION

- If property is damaged, but not totally destroyed, the amount of a casualty loss is equal to:
  - The lesser of (1) the property's adjusted basis or (2) its decline in value, which is the fair market value of the property after the disaster subtracted from its fair market value before the disaster
  - ***Minus***
  - Expected insurance or reimbursement received

[Treas. Reg. § 1.165-7(b)(1)].

EXAMPLE 4.1

- John's multipurpose farm building was severely damaged by hurricane force winds.
- John's adjusted basis in the building, for which he had taken straight-line depreciation, was $100,000.
- The value of the building before the storm was $200,000. The value of the building after the storm was $150,000.
- John received $40,000 in insurance proceeds to compensate him for the damage. **How is John's casualty loss calculated?**

EXAMPLE 4.1

- $50,000 (lesser of adjusted basis or decline in value) - $40,000 (insurance payment) = **$10,000 casualty loss**
- *The basis, insurance payment, fair market value before casualty, and fair market value after casualty are reported on IRS Form 4684, Section B. The loss is reported on Form 4797 as an ordinary loss if a Form 4797 is otherwise required to be filed.*
- *If no Form 4797 is otherwise required, a taxpayer can report the loss on Form 1040, Schedule 1, line 4, with a note, “Form 4684.”*

EXAMPLE 4.1

- John’s basis in the barn is decreased by the insurance proceeds received and the casualty loss recognized.
- It is increased by the amount spent on restoration.
- The new basis in John’s barn after the recognized loss is $50,000 ($100,000 - 40,000 - 10,000) *[I.R.C. § 1016(a)(1)].*
- If John uses the insurance proceeds to restore the roof, the barn’s basis is increased to $90,000 ($50,000 + 40,000).

DETERMINING FAIR MARKET VALUE

- The law allows the taxpayer to establish the FMV of the property before the casualty by either: (1) obtaining an appraisal from a competent appraiser *[Treas. Reg. 1.165-7(a)(2)(i))]* or (2) by using the cost of repairs method. *[Treas. Reg. 1.165-7(a)(2)(ii)].*
- The IRS will review each return based on the particular facts and circumstances.
- Taxpayers can face substantial underpayment of tax penalties for overvaluations.

DETERMINING FAIR MARKET VALUE

- When determining the decrease in FMV of the property after a disaster, the cost of cleaning up or repairing property may be used only if the following conditions 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 isn't 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.

TOTAL DESTRUCTION

- If the property is completely destroyed, the decrease in fair market value is not considered and the casualty loss is equal to:
  - The property's adjusted basis
  - Minus
  - Any salvage value minus insurance proceeds or reimbursement expected to be received. *[Treas. Reg. § 1.165-7(b)(1)(ii)].*

EXAMPLE 4.2

- Helena had a hog building with a fair market value of $250,000 and an adjusted basis of $150,000 when it was totally destroyed by a hurricane.
- If she receives $100,000 in insurance proceeds, her casualty loss is $50,000 ($150,000 – 100,000).
- *The basis, insurance payment, fair market value before casualty and fair market value after casualty are reported on Form 4684, Section B. The loss is reported on Form 4797 as an ordinary loss.*

DEMOLITION COSTS

- Under I.R.C. § 280B, demolition costs and the basis of any destroyed structures are generally capitalized and added to the basis of the land on which the demolished structures were located.
- If a casualty damages or destroys a structure, and the structure is then demolished, the basis of the structure must be reduced by the casualty loss allowable under I.R.C. § 165 before the "loss sustained on account of" the demolition is determined. *[IRS Notice 90-21].*

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EXAMPLE 4.3

- In the last example, Helena's adjusted basis in the destroyed hog building after subtracting the insurance proceeds and the casualty loss is zero. Any demolition and removal costs would be added to the basis of the land. The cost of any new building would become the new building's basis. *[I.R.C. § 1016(a)(1)].*
  - Helena's hog building was located on a 10-acre parcel of land that she purchased in 2010 for $50,000. If she paid $10,000 to have the destroyed building demolished and the building site restored, the basis of the land is now $60,000. If she spends $300,000 to rebuild the hog building, the basis in the building is $300,000.

GENERAL BUSINESS CASUALTY LOSS RULES

- Business casualty losses are determined on a property-by-property basis. Taxpayers are not allowed to aggregate their properties together when making the calculation.
- A taxpayer may elect to take into account any loss occurring in a disaster area and attributable to a federally declared disaster for the taxable year **immediately before the taxable year in which the disaster occurred**.
- This election is made on an amended return for the prior year.

GENERAL BUSINESS CASUALTY LOSS RULES

- If a taxpayer deducts a casualty loss but then receives a reimbursement in a later year, the taxpayer does not amend the earlier return, but instead, includes the reimbursement in income for the year in which the reimbursement is received in accordance with the tax benefit rule.
- *Passive loss rules do not apply to business casualty losses. [I.R.C. § 165(c)(3)].*

INSURANCE PROCEEDS

- Casualty losses are determined based upon **actual and expected proceeds**.
  - Any casualty loss must be reduced by these proceeds, even if the payment won't be made until the following year.
- In the year of reimbursement, the amount may need to be adjusted on that year's tax return.
  - If the <u>reimbursement is less</u>, a loss is realized in the year of reimbursement.
  - If the <u>reimbursement is more</u>, the reimbursement is included in income, but only to the extent the original casualty loss deduction reduced tax for the prior year.

CASUALTY GAIN

- If the total insurance compensation that a taxpayer receives is more than the adjusted basis in the destroyed or damaged property, the taxpayer will have a casualty gain, not a loss.
- This is common with farm assets that are frequently fully expensed or depreciated.
- Taxpayers faced with a casualty gain may have the option to defer the gain and reinvest proceeds.

CASUALTY GAIN

- Gain is figured as follows.

  - **The amount received as insurance proceeds minus the adjusted basis in the property at the time of the casualty or theft.**

- Even if the decrease in fair market value of the property is smaller than the adjusted basis of the property, the adjusted basis is used to figure the gain.

EXAMPLE 4.4

- Suppose Helena from the last example took an I.R.C. § 179 expense deduction when she built her hog building and her basis in the building was zero when the hurricane struck.
- In this case, the $100,000 of insurance proceeds for the destroyed hog barn is a casualty gain ($100,000 – 0).

EXAMPLE 4.4

- *The basis, insurance payment, and gain on the building is reported on Form 4684.*
- *Because the building is I.R.C. § 1245 property, its deemed sale must be reported on Part III of Form 4797.*
- This is reported as ordinary income, not subject to self-employment tax if Helena chooses to recognize the gain.
- **But see the involuntary conversion section below for a deferral option.**

INVOLUNTARY CONVERSION

- Whether a casualty gain is presently taxable depends upon whether the insurance proceeds are reinvested in replacement property.
- *Under I.R.C. § 1033(a)(2)(A), a taxpayer may elect to defer the gain if the replacement cost is equal to or greater than the insurance recovery*.
- The basis from the destroyed property is carried over to the basis for the replacement property and the gain is recognized upon any future sale of the replacement property.

INVOLUNTARY CONVERSION

- To qualify for deferral, the taxpayer must purchase replacement property that is "similar or related in service or use to the property destroyed" or the taxpayer must purchase a controlling interest (at least 80 percent) in a corporation owning such property.
- The property must generally be replaced **within two years** after the close of the first taxable year in which any part of the gain is realized, although the Secretary of the Treasury may extend that period. *[I.R.C. § 1033(a)(2)(b)].*
- If a personal residence is in a federally declared disaster area, the replacement period is extended to four years.

GENERAL ELECTION RULES

- A taxpayer must report the details of an involuntary conversion resulting in gain for each tax year in which the gain is realized. *[Treas. Reg. § 1.1033(a)-2(c)(2)]. Taxpayers must use IRS Form 4684 to report involuntary conversions due to a casualty.*
- A taxpayer chooses to defer casualty gain by not reporting gain in the first year it is realized. A statement including the details of the conversion is attached to the return.
- Another statement must be attached to the return for the year in which the taxpayer acquires the replacement property. This statement must contain detailed information about the property.

EXAMPLE 4.5

- Helena from the last example may elect to defer recognition of the $100,000 gain if she spends at least $100,000 to construct another building within 2 years.
- If she chooses deferral, she reduces the basis of the new hog barn in the amount of $100,000 to account for the casualty gain.

EXAMPLE 4.5

Helena's Deferral Statement

Election under I.R.C. § 1033(a)(2) not to Recognize Gain from Compulsory or Involuntary Conversion

Taxpayer hereby elects in accordance with I.R.C. § 1033(a)(2) and Treas. Reg. § 1.1033(a)-2 not to recognize a realized gain in the amount of $10,000 from the involuntary conversion of certain property owned by taxpayer and described more fully as follows: Grain bin at 123 Rural Road West; Westtown, MO 65098.

The involuntary conversion occurred on March 27, 2024. The realization of gain occurred on July 3, 2024, during the current tax year. Taxpayer intends to replace the converted property within the replacement period with property that is similar or related in service or use to the converted property.

SPECIAL RULE FOR FEDERAL DISASTER AREA

- *A special rule exists for casualty gains arising in a federal disaster area. Under I.R.C. § 1033(h)(2),* ***any tangible replacement property held for use in a trade or business*** *is treated as similar or related in service or use to any property held for use in a trade or business or for investment if:*
  - *The property being replaced was damaged or destroyed in a disaster, and*
  - *The area in which the property was damaged or destroyed was declared by the President of the United States to warrant federal assistance because of that disaster.*

EXAMPLE 4.6

- If Helena in the last example was in a federally declared disaster area, she could defer recognition of the casualty gain by purchasing any tangible trade or business property.
- She could decide not to rebuild the hog building and elect, for example, to defer the gain and subtract it from the basis of a new tractor purchased for her farming business.

REPAIRING CASUALTY DAMAGED PROPERTY

- If the reduction in basis is less than or equal to the taxpayer's adjusted basis in the building, amounts paid to restore the damage to the building must be capitalized as an improvement.
- If the amounts paid to restore the property **exceed the adjusted basis of the property** prior to the loss, the amount required to be capitalized is limited. In that case, costs required to be capitalized are limited to the excess (if any) of the taxpayer's basis adjustments resulting from the casualty minus the amount paid for restoration that constitutes a restoration under one of the other five criteria of *Treas. Reg. § 1.263(a)-3(k)(1).*

EXAMPLE 4.7

- A storm damaged Jerry's farm building that had a $75,000 adjusted basis. Jerry received $75,000 in insurance proceeds to compensate for the damage. He then paid $90,000 to repair the damage and restore the building to its prior condition.
- The insurance payment lowers the basis of the building to zero, but when Jerri repairs the building, the $75,000 of repairs in the amount of the insurance payment are capitalized. Jerri may also **deduct $15,000 as repair costs under *Treas. Reg. § 1.263(a)-3(k)(1)* if the costs were expended to repair or restore the building.**

PERSONAL USE PROPERTY

- Casualty losses and gains must be considered for damage to personal use property as well. The rules for this type of property, however, are very different.
- The Tax Cuts and Jobs Act changed the law so that from 2018 to 2025, personal casualty losses are deductible only if they are attributable to a federally declared disaster. Outside of a disaster area, a personal casualty loss remains deductible if the taxpayer has personal casualty gain, to the extent that the loss doesn't exceed the gains. *[I.R.C. § 165(h)(5)].*
- NOTE: This rule will likely be extended beyond 2025 based upon the election results.

PERSONAL USE PROPERTY

- For taxpayers experiencing loss of personal use property in a federally declared disaster area, two limitations apply to a casualty loss deduction: (1) the loss must exceed $100, and (2) aggregate losses may be deducted only to the extent they exceed 10 percent of adjusted gross income.
- Taxpayers with property used partly for personal use and partly for business use must allocate the loss amount.
- The involuntary conversion rules apply to personal use property.

CROP INSURANCE AND DISASTER PROCEEDS

- Insurance proceeds for disaster-related damage are included in gross income.
- Cash basis farmers generally include payments in income in year of receipt.
- Election to defer may be an option.

DEFERRAL ELECTION – GENERALLY

- Under IRC § 451(f), cash basis farmers can *elect* to include crop insurance proceeds in gross income for the tax year **following the tax year of the destruction or damage**.
- Prevents income bunching where farmers have typically sold crops in following tax year.
- Election is not available if the proceeds are received in the year following the year of damage.

WHAT PAYMENTS QUALIFY FOR DEFERRAL?

- Applies to insurance payments received as a result of destruction or damage to crops.
- It also applies to disaster payments received from the federal government.
  - *Treas. Reg. §1.451-6(a)* extends federal election to all federal payments received ***as a result of destruction or damage to crops*** caused by natural disasters or the ***inability to plant*** crops because of such a natural disaster.

DEFERRAL REQUIREMENTS

- Must use cash method of accounting.
- Establish that, ***under normal business practices***, income from the sale of the crops would have been included in gross income in a tax year following the year of destruction.
- Election is made for ***entire trade or business***.
  - Must treat disaster and crop insurance payments the same.
  - Must generally elect to defer ***all or none***.

NORMAL BUSINESS PRACTICE

- Taxpayer establishes its normal business practice to include income from the crops in a subsequent year by a declaration on the election statement.
- Must show he or she would have reported a **substantial portion** of the income in the year following damage or destruction.
  - Probably **more than 50 percent** for **each crop** in the Eighth Circuit.
  - Does not apply to crops for which farmer is not receiving damage payments.

EXAMPLE 4.8

- Royal received $12,000 in 2024 for prevented planting crop insurance coverage for his soybean crop.
- He also received $8,000 in disaster assistance payments for damage to his corn crop in 2024.
- He operates his farm as a single trade or business. Royal normally sells both his corn and soybeans in the year following harvest.

EXAMPLE 4.8

- Can Royal elect to report the $8,000 in disaster payments in 2025, but report the $12,000 in crop insurance in 2024?

EXAMPLE 4.8

- Can Royal elect to report the $8,000 in disaster payments in 2025, but report the $12,000 in crop insurance in 2024?
- NO. Because Royal has a single trade or business, he must elect deferral for both crops or for neither crop. It does not matter that one payment was “disaster aid” and one payment was crop insurance. They are both treated as crop insurance and must be treated as one payment.

EXAMPLE 4.8

- Assume Royal has historically received substantially similar income from his corn crop and his soybean crop.
- He has, however, generally sold 60 percent of his corn crop in the year of harvest and 65 percent of his soybean crop in the year after harvest.
- Would Royal be eligible to defer recognition of his crop insurance and proceeds to 2025?
  - Under the Eighth Circuit Court of Appeals' interpretation in Nelson, NO. The court in that case stated that the "more than 50 percent test" had to be met for each crop for which an insurance payment was being made. Outside of the Eighth Circuit the answer is MAYBE. **The hurricane areas are outside the Eighth Circuit Court of Appeals.**

EXAMPLE 4.8

- Suppose Royal planted soybeans through his own sole proprietorship but received the disaster payment for the corn crop through a partnership in which he is a 50 percent partner. Can Royal elect to report his $8,000 in disaster payments in 2024, even if his partnership elects to defer income recognition for its crop insurance proceeds to 2025?
  - YES. Since these are separate trades or businesses, they must make separate election decisions, and those elections may be different.

MAKING THE ELECTION

- Must attach a separate, signed statement to the return or amended return for the year of damage or destruction.
- Elections, once made, cannot be revoked absent consent by the IRS district director.
  - Requests are made through a letter to the director.

REVENUE POLICIES - ALLOCATION

IRS Publication 225 Statement

Although IRS has provided no allocation guidance, the IRS Publication 225 confirms the need for an allocation: "Proceeds received from revenue insurance policies may be the result of either yield loss due to physical damage or to decline in price from planting to harvest. For these policies, only the amount of the proceeds received as a result of yield loss can be deferred."

WEATHER-RELATED SALES OF LIVESTOCK

- Gain on weather-related sales of **<u>any</u>** livestock may be deferred under IRC § 451(g).
- May elect to <u>defer reporting of income from</u> livestock **sold, in excess of normal sales,** because of **drought, flood, or other weather-related conditions.**
- Include income from these extra animals in the **tax year following** the tax year in which the sale or exchange occurred.

  This is a <u>one-year deferral.</u>

SECTION 451(G) DEFERRAL

- Principal trade or business must be farming
- Taxpayer must use cash method of accounting
- Taxpayer must establish that under normal business practices the sale or exchange would not have occurred in year it did, but for disaster extra animals were sold.
- Conditions caused the area to be **eligible for federal assistance.**
  - The designation can be made by the President, the Department of Agriculture (or any of its agencies), or by other federal departments or agencies.

WHAT IS DEFERRED?

- Deferrable gain is calculated based upon difference between quantity sold and quantity that would have been sold had the taxpayer followed **usual business practices**.
  - The determination of the number of animals which farmers would have sold if they had followed usual business practice is made "in light of all facts and circumstances." *[Treas. Reg. § 1.451-7(b)].*
  - In the case of taxpayers who have not established a usual business practice, IRS will look to the usual business practice of similarly situated taxpayers in the same general region as the taxpayer.

MAKING THE ELECTION

- Separate elections can be made for each broad category of animals (hogs, sheep, cattle), but not for sex, breed, or age.
- If the livestock are held for sale in the ordinary course of business, the election must be made by the **due date of the return** (including extensions) for the tax year in which the drought sale occurred.
- If the livestock are held for **draft, breeding, or dairy purposes**, then the election can be made any time in the 4-year replacement period for the postponement of gain from sales caused by a disaster that resulted in a disaster area declaration under I.R.C. § 1033(e)(2).
  - You would then go back and **amend if you decide a one-year deferral is better** than replacement.

EXAMPLE 4.9

- In 2024, Trey's pasture flooded during a severe storm. His farm was located in a federally declared disaster area.
- As a result of the flood, Trey sold 150 market cattle, including 100 he would not have sold until 2025 had it not been for the flood. Trey received $270,000 for the cattle he sold.
- Because Trey is a cash basis taxpayer whose principal trade or business is farming, I.R.C. §451(g)(1) allows him to defer for one year the income he received from the 100 head he sold due to the flood.
- Trey may report $180,000 of his income [(100/150) x $270,000 = $180,000] in 2025 instead of 2024 by attaching a statement to his timely filed 2024 return.

- Taxpayer is postponing gain under Internal Revenue Code (IRC) section 451(g).
- On March 15, 2024, a flood severely impacted Georges County, Iowa, rendering taxpayer's pasture unsuitable for cattle. On March 29, 2024, Georges County, Iowa, was declared a Presidential disaster area because of the flood (see attached declaration).
- Taxpayer has for the prior three years (2021, 2022, and 2023), sold 49, 50, and 52 cattle respectively. In 2024, he would have sold 50 cattle had the flood not occurred. Instead, he was required to sell the entire herd, which included 150 head of cattle.
- Taxpayer sold the 150 animals on March 27, 2024, for $270,000. He is deferring $180,000 of his income from the sale attributable to the 100 cattle that he would not have sold in 2024, but for the flood [(100/150) x $270,000 = $180,000].

LIVESTOCK OUTSIDE OF DISASTER AREA

- Livestock need not be raised or sold in the federally-declared disaster area.
- But must show that the sale or exchange occurred solely **on account of the weather-related conditions**, which impacted water, grazing, and other requirements.
  - Cost of feed, etc. was substantial in relation to the cost of holding the livestock.

INVOLUNTARY CONVERSIONS (DIFFERENT OPTION)

IRC § 1033(e) allows taxpayers to defer gain on livestock (other than poultry) held for any length of time for **draft, breeding, or dairy purposes** if:

- Livestock is sold because of drought, flood, or other weather-related conditions, **and**
- The sale would not have occurred under the taxpayer's usual or normal business practices.
  - **No requirement for a federal disaster, just need to prove a weather condition caused the sale.**

REPLACEMENT PERIOD

- To postpone gain, the taxpayer must generally purchase replacement livestock within 2 years of the end of the tax year of the sale.
- *If eligible for federal assistance*, the **replacement period is extended to four years.**
  - IRS can also extend the replacement period for the weather-related event (generally drought) beyond the four years (if drought has lasted more than three years).
    - *The most recent notice, IRS Notice 2024-70, was issued September 30, 2024. (Also refer to IR 2024-248)*

REPLACEMENT PROPERTY

- Replacement livestock must generally be of the **same kind as the original livestock** (i.e. breeding heifers for breeding heifers).
- If, however, because of the disaster it is **not feasible** for the taxpayer to reinvest the proceeds into similar property, it can be reinvested in other property used for farming purposes (not real property unless caused by soil contamination)

EXAMPLE 4.10

- It is Tia's usual business practice to sell five raised breeding heifers during the year. In 2024, Tia sold 20 breeding heifers for $28,200 because her pasture was flooded.
- Her basis in the animals was $0. Because of the weather-related event, Tia may elect to postpone the $21,150 gain (15/20 x $28,200) on 15 of the animals by treating their sale as an involuntary conversion.
- (see the statement on the following slide).

Flooding conditions evidenced by the attached disaster report forced the taxpayer to sell 20 breeding heifers rather than her usual five. The raised animals have a zero-tax basis. 20 animals sold for \$28,200. Pursuant to I.R.C. § 1033(e), the taxpayer elects to defer recognition of gain on the extra 15 animals that were sold because of the flood. Deferred gain = (15/20) x \$28,200 = \$21,150.

EXAMPLE 4.10

- When Tia purchases 15 replacement breeding heifers in 2026, her basis in them will be $0, plus any price she must pay for the animals in excess of $21,150 (the deferred gain). She must attach to her 2026 return a statement including:
  - The date the replacement heifers were bought.
  - The cost, number, and kind of replacement heifers.
  - A copy of the information attached to the 2024 return.
- If Tia pays less than $21,150 for the replacement heifers, she must amend her 2024 return to pay tax on the difference between the amount paid and $21,150. She will owe interest on this unpaid tax, but will not incur an accuracy-related penalty. If Tia dies before replacement heifers are purchased, her executor must amend the 2024 return to report the deferred income.

DEFERRAL CONSIDERATIONS

- Before a taxpayer defers income or gain eligible to be deferred because of a natural disaster, they should consider several factors, including:
  - The taxpayer’s income tax bracket in the past, current, and future tax years
  - How income averaging might impact the farmer's overall tax liability
  - Self-employment tax liability on the income
  - Section 179, depreciation, or bonus depreciation elections
  - Whether the farmer has losses that might offset the income
  - How income deferral might impact the farmer’s eligibility for retirement plan contributions
  - The impact of off-farm income
  - Whether the deferral would affect the farmer's qualification as a “farmer” for provisions such as the special estimated tax rules for farmers

Reconstructing Records

- IRS Pub 2194, Disaster Resource Guide: prescribes methods to reconstruct records
- Likely essential for tax purposes, getting federal assistance, or insurance purposes
- Historical information most likely lost but can be reconstructed for real property, vehicles, machinery, equipment, personal property, business records, etc.

Documenting Losses

- Photographs (before and after loss)
- Inventories (receipts for purchase)
- Tax Records (depreciation schedule)
- Federal disaster declaration reports
- Consult your tax advisor as quickly as possible after the casualty or disaster

References

RuralTax.org: “Disaster Losses and Related Tax Rules” (RTE 2022-07)

- Examples for different property or assets
- How to reconstruct your records
- List of helpful IRS publications and resources

RuralTax.org: “Tax Guide for Owners and Operators of Small and Medium Sized Farms”

Thank you for Attending!!

What questions might you have?

For any follow-up questions contact:

janet.wright@usda.gov