1-3-1996

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LIVESTOCK SOLD OR DESTROYED BECAUSE OF DISEASE

— by Neil E. Harl*

Although less widely used than the provisions on the one-year deferral of gains from livestock sold because of drought and the two-year reinvestment for drought sales of livestock held for draft, dairy or breeding purposes, the provision providing relief for livestock destroyed, sold or exchanged because of disease can be highly important to farmers and ranchers.

Treated as involuntary conversion

If livestock are destroyed or are sold or exchanged because of disease, the disposition may be treated as an involuntary conversion. Thus, recognition of the gain can be avoided if the proceeds are reinvested in property similar or related in service or use. The replacement period ends two years after the close of the taxable year in which the involuntary conversion occurs and any part of the gain is realized. Amounts received are not excludable from income if the funds are not reinvested in replacement animals. The basis of the new animals must be reduced by the unrecognized gain on the old (destroyed, sold or exchanged) animals.

Losses due to the death of livestock from disease, whether from normal death loss or a disease of epidemic proportions, are treated as an involuntary conversion. The "suddenness" test need not be satisfied in order to have a particular occurrence be considered an involuntary conversion. Since animal disease does not qualify under the "suddenness" test as a casualty, losses because of death of livestock from disease ordinarily are not considered casualty losses within the meaning of I.R.C. § 1231(a) and are not entitled to the treatment afforded casualty losses under I.R.C. § 165(c)(3).

For the loss of animals from feed contamination, the involuntary conversion provision is available. Thus, in a 1954 ruling, the disease of hyperkerotosis, acquired from consuming lubricants in pelleted feed, made the livestock consuming the feed eligible for involuntary conversion treatment.

The Internal Revenue Service has ruled, however, that dwarfism in beef cattle is not a disease so the sale of a herd which had developed the dwarf gene is not eligible for involuntary conversion treatment. The problem is one of genetics, not of disease.

Livestock exposed to disease are considered sold or exchanged under this provision.

A question has been raised as to the scope of the term "livestock," which is included in the statute rather than "animals." The term "livestock" is not defined in the involuntary conversion statute but is defined in I.R.C. § 1231. In that provision, the term "livestock" includes "cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals and other mammals." The term, as defined in that provision, does not include poultry, chickens, turkeys, pigeons, geese, other birds, fish, frogs or reptiles. Nonetheless, the destruction of honeybees as a result of pesticide application has been ruled to be an involuntary conversion. In that ruling, a beekeeper qualified for indemnity payments for the loss of honeybees as a result of pesticide use near the beehives. The destruction of the honeybees was considered a casualty, eligible for a casualty loss where the payments were less than the taxpayer's basis in the property.

Environmental or soil contamination

An additional provision, enacted in 1978, applies to the replacement of livestock with other farm property in the event of environmental or soil contamination. If it is not feasible to reinvest the proceeds from compulsorily or involuntarily converted livestock in property similar or related in use to the livestock converted, other property (including real property) used for farming purposes may be treated as similar or related in service or use to the livestock converted. In a 1985 case involving the sale of breeding cattle because of brucellosis ("Bang's" disease) which made the animals unsuitable for breeding, the communicable disease was not considered to be an environmental contaminant. In that case, the sale did not qualify for the environmental contamination provision.

It is important to note that only in the case of environmental contamination would the taxpayer have the option of replacing involuntarily converted livestock with

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other farm property. In the event of loss from disease, the reinvestment must be in replacement animals.

In a 1985 U.S. District Court case, involving loss of cattle from brucellosis, the taxpayer argued that the bacteria or organisms causing the disease were transmitted to the animals from the environment. Had the court bought that argument, the proceeds could have been invested in "other farm property." The court held that such a result would render the animal disease provision impotent which the court was unwilling to do.

FOOTNOTES
2 I.R.C. § 1033(e). See generally 4 Harl, supra n. 1, § 27.03[7][d][i]; Harl, supra n. 1, § 4.02[5][b].
3 I.R.C. § 1033(d).
4 Id.
5 I.R.C. § 1033(a), (d).
8 Treas. Reg. § 1.1033(b)-1.
11 Id.
13 Id. The ruling was modified by Rev. Rul. 59-102, 1959-1 C.B. 200 ("suddenness" test need not be met).
15 Id.
16 Treas. Reg. § 1.1033(d)-1.
17 I.R.C. § 1033(d).
19 Id.
20 Id.
22 Id.
23 Id. See I.R.C. § 165(a).
24 I.R.C. § 1033(f).
25 Id.
27 Id.
29 Id.
31 I.R.C. § 1033(f).

CASES, REGULATIONS AND STATUTES
by Robert P. Achenbach, Jr.

BANKRUPTCY

CHAPTER 12-ALM § 13.03[8].

DISPOSABLE INCOME. The debtors had requested a discharge at the end of their plan period but a creditor objected that all disposable income had not been paid to the trustee. The debtors argued that 326 calves should not have been included in the debtors’ assets because the calves were not of marketable weight during the plan period. The court held that, although the calves would not receive full value, the calves did have some value and that value would be included in the debtors’ assets as disposable income. The debtors also argued that government payments received after the end of the plan period should not have been included in disposable income. The court held that the payments were included because the payments related to activities which occurred during the plan. The debtors argued that payments made on a real estate loan and for real property taxes during the plan period reduced the disposable income. The court found that the loan payments and taxes were not due until after the plan period was over; therefore, the court held that the payments did not reduce disposable income. In re Hammrich, 98 F.3d 388 (8th Cir. 1996).

FEDERAL TAXATION-ALM § 13.03[7].

AUTOMATIC STAY. The debtor had first filed for Chapter 7 and, when that case was completed, filed for Chapter 13. The IRS filed only a small claim for taxes and penalties, but the debtor’s Chapter 13 plan provided for full payment of a much larger tax claim filed by the debtor but did not include some employment taxes. The IRS had notice of the Chapter 13 action but failed to object or appeal the plan or discharge in the Chapter 13 case. However, the IRS made several attempts to collect the unpaid taxes by assessment, letter and levy against the debtor’s property and wages. With each violation of the automatic stay, the IRS abated its efforts after contact by the debtor’s attorney. The court rejected the IRS’s six violations of the automatic stay. The court rejected the IRS argument that the IRS made the collection attempts because the IRS reasonably believed that the taxes were not discharged in the Chapter 13 case. The court held that the IRS argument was inconsistent with its actions to halt collection after each contact by the debtor’s attorney. The court awarded the debtor $1,500 in attorney’s fees necessitated by the IRS’s six violations of the automatic stay. In re Thibodaux, 201 B.R. 827 (Bankr. N.D. Ala. 1996).

Although the IRS received notice of the debtors’ Chapter 7 case, the IRS made a post-petition levy against the debtors’ bank account causing several checks issued by the debtors to incur insufficient funds charges when the checks were returned unpaid to local merchants. The debtors sought recovery of the charges, $2,000 for “trauma and embarrassment” and punitive damages. The court allowed