

# Department of Agricultural and Resource Economics

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## LIVESTOCK SALES—UNDERSTANDING TAX IMPACTS

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### Introduction

How farm livestock sales records are kept and the reporting of livestock sales on an income tax return can have a major impact on taxes owed. Correctly reporting sales that qualify for capital gains treatment can reduce income and self-employment taxes. This document reviews the different types of livestock sales and tax impact of the sales. Additional information can be found in [IRS publication 225-Farmer's Tax Guide](#).

### Types of livestock sales

Generally, there are two types of livestock sales: sales from livestock which are primarily held for that purpose and livestock held for breeding, draft and milking purposes.

### Sales of livestock

An animal raised or purchased with the objective to sell the animal (market livestock) means the animal is not intended to become breeding livestock (breeding livestock covered later). The income from the sale of such livestock is ordinary income. Ordinary income tax rates will apply.

Income from sales of livestock held for breeding, draft or milking purposes may qualify as short- or long-term capital gains income. The tax rates for capital gains is generally lower than the ordinary income tax rates. Also, capital gains income is not subject to self-employment tax.

Keeping sufficient records to accurately track types of animals sold and communicating the sales accurately to an income tax preparer can reduce taxes owed.

### Livestock for resale

Income from cattle, sheep, swine or other market animals that are intended to be sold after raising or purchase is generally considered ordinary income. Raised animals have zero cost or basis, as the expense of raising was deducted as they were raised. The cost of any selling expenses are subtracted from the selling price of the raised animal to determine the net income from the sale. The net income from purchased animals is determined by subtracting the cost of the animal and the selling expenses from the sales price. Sales of market animals are considered ordinary income and are reported on Schedule F and Form 1040. This income is taxed as ordinary income and is subject to self-employment tax.

**Example 1.** Farmer A raised a group of calves to 500 pounds each. When sold, the income is reported on Schedule F, line 2 (sales of livestock, produce, grains and other products you raised). The marketing expenses of selling the animals are deducted as other expenses. The transportation expense of selling the animals would also be reported.

**Example 2.** Farmer B purchased a group of calves at 250 pounds each and sold them when they reached 500 pounds. The income from the sale is reported on Schedule F, line 1a (sales of livestock and other resale items). The cost of the calves when purchased is reported on Schedule F, line 1b (cost of other basis of livestock or other items). The difference is reported on Schedule F, line 1c. Other expenses incurred in the feeding, care, marketing and transportation are deducted as farm expenses on Schedule F.

## Breeding, draft and milking livestock sales

The term “breeding livestock” will be used to describe sales of all livestock held for breeding, draft and milking. The reporting of income from breeding livestock depends on three factors: 1) whether the animal was raised or purchased; 2) how long the animal was held for breeding (see holding period, below); and 3) whether the sale resulted in a gain or loss. (Examples of cattle sales follow; the rules are generally the same for all types of livestock.)

### Raised breeding livestock

A farmer has no cost (basis) in the animal raised since the expenses of raising the animal were deducted during the time it was raised. The sale of the breeding livestock will result in a taxable capital gain. The sale of the breeding livestock will be reported on Form 4797 (sale of business property). These sales could include cows and heifers raised for breeding purposes, bulls and cull animal sales.

**Example 3.** Farmer C sells a four-year-old cow he has raised. Any expenses from the sale are deducted from the gross sales price and reported on Form 4797, Part I, as a long-term gain. This gain would be combined with other gains and losses to determine a net gain or loss for the year and might be subject to capital gains tax (see tax rates, below).

### Purchased breeding livestock

Depending on the purchase and selling price, the sale of purchased livestock could result in either a taxable gain or loss. Purchased breeding animals can be depreciated like other assets used in a business. The gain or loss will be calculated by subtracting selling price from purchase price and adjusting for any depreciation recapture, if applicable.

**Example 4.** Farmer D sells a cow purchased four years ago. The amount of depreciation taken on the cow is subtracted from the original cost to determine the current basis (value) of the cow. The current basis is subtracted from the selling price, along with any expense of the sale, to determine the gain or loss on the sale; it is reported on Form 4797, Part I.

In examples 3 and 4, above, the sale of the cows held over two years might be subject to capital gains taxes. However, since they were held over 24 months, the gains would be long-term capital gains and not ordinary income and would not be subject to self-employment tax.

## Holding period

The length of time the animal is held on the farm determines whether the sale qualifies as a long-term capital gain. Generally, the holding period is 24 months for cattle and horses and 12 months for other livestock.

Other observations:

1. There are some exceptions to the holding period rules for situations like weather-related sales of livestock.
2. An animal (like a heifer) that is raised with the intent to become breeding livestock but is found to be sterile could still be sold as breeding livestock, if sold within a reasonable time.
3. When an entire herd of animals are being sold or liquidated, the younger animals that would have become breeding livestock, generally, could be considered breeding livestock for tax purposes.

## Difference income reporting makes

**Example 5.** Farmer D from example 4 is going to estimate the income tax impact and report the sale both ways. For this example, it is presumed Farmer D had \$50,000 of other taxable farm income and is married, filing a joint return. The cow was purchased for \$1300. A depreciation of \$867 has been taken, and the sale expenses were \$125. The cow was sold for \$1250. The gain on the sale would be \$692. If this is the only capital gain for the year, and since the farmer's income is below \$77,200, the farmer would be in the zero capital gains tax rate bracket and would owe no capital gains tax. The calculation might look like:

Gross selling price	\$1250
Original cost	\$1300
Depreciation	- 867
Adjusted basis	\$ 433
Expense of sale +125 =	\$ 558
Gain realized	\$ 692

If Farmer D had mistakenly reported the sale of the cow for \$1250 as other farm income on Schedule F and \$50,000 is their adjusted taxable income, it is estimated they would pay an additional \$150 in income tax (12% of \$1250), and self-employment tax would increase by an additional \$176 ( $\$1250 \times .9235 \times 15.3\%$ ). This amounts to an estimated \$326 in additional taxes paid on the sale of one cow. Imagine the impact if all cattle sales qualifying as long-term capital gains were reported incorrectly.

### Current Tax Rates—Ordinary Income (2018 brackets)

Tax Rate	Single	Married (Joint)
10%	Up to \$9,525	Up to \$19,050
12%	\$9,526 to \$38,700	\$19,050 to \$77,400
22%	\$38,701 to \$82,500	\$77,401 to \$165,000
24%	\$82,501 to \$157,500	\$165,001 to \$315,000

Higher rates apply to higher income levels.

### Current Long-Term Capital Gains Tax Rates (2018)

Tax Rate	Single	Married (Joint)
0%	Up to \$38,600	UP to \$77,200
15%	\$38,601 to \$425,800	\$77,201 to \$479,000
20%	Over \$425,800	Over \$479,000

Higher rates might apply to collectibles and other specific situations.

## References

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