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Financial Options for Livestock Producers During Natural Disasters

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Introduction

Natural disasters affecting the agricultural industry occur regularly throughout the United States and may receive a disaster designation from the United States Department of Agriculture (USDA). Disaster payments through various programs from 2014-2018 totaled over $63.6 million in Arizona (EWG, 2020). Agricultural disasters often place economic hardships on producers. Producers in arid/semiarid regions like the southwest U.S. are particularly susceptible to the impacts of drought while other regions may be more susceptible to other disasters such as blizzards and extreme cold (e.g. Northern Great Plains). To alleviate some of these economic hardships faced by producers, certain relief programs correspond directly with the US Drought Monitor (USDM) map. The USDM is a map authored each week to delineate drought conditions across the US (Figure 1).

Many designations are dependent on drought categories depicted on the USDM. One of the most immediate impacts of the USDM is the ability to trigger an emergency disaster designation. Producers may benefit from disaster relief programs including, but not limited to, the Livestock Forage Disaster Program, emergency loans, or tax deferrals.

For an overview of the USDM please see, The U.S. Drought Monitor, AZ 2018-0637. To review the types of data used to inform the USDM please see, Monitoring Drought in Arizona, AZ 2020-0709. To access the USDM, please visit: https://droughtmonitor.unl.edu/.

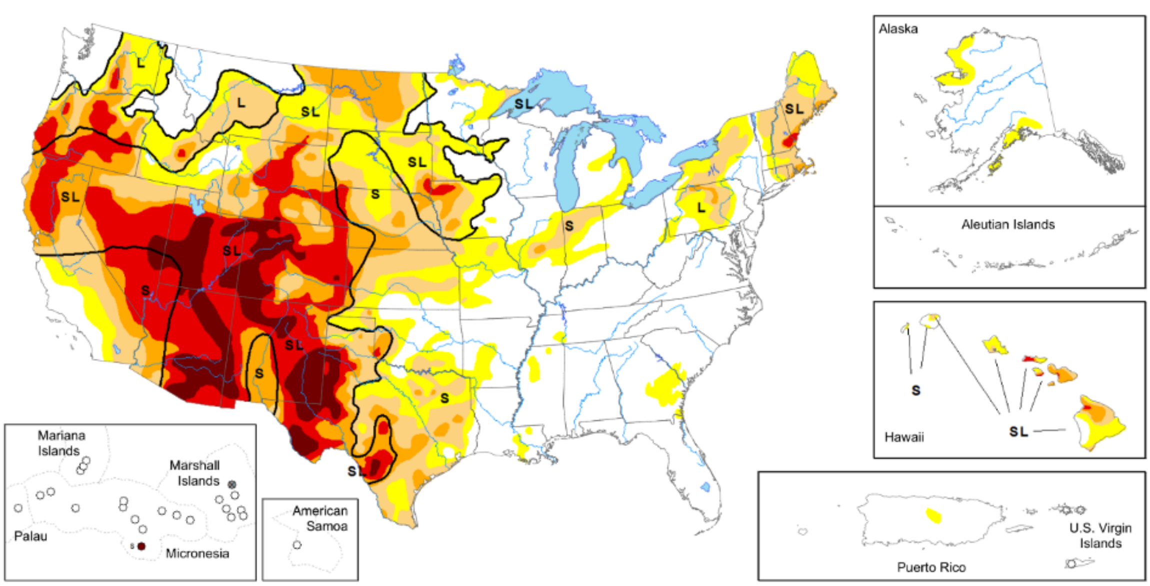

Figure 1. The U.S. Drought Monitor from November 19, 2020 illustrates the extent and intensity of drought. The U.S. Drought Monitor is jointly produced by the National Drought Mitigation Center at the University of Nebraska-Lincoln, the United States Department of Agriculture, and the National Oceanic and Atmospheric Administration. Map courtesy of NDMC-UNL

Drought Response Triggers

In 2012, USDA streamlined the Secretarial disaster declaration process with the Farm Service Agency (FSA) at the local level, resulting in a more efficient and timely process for agricultural producers. Additional program improvements include nearly automatic disaster designations for severe drought. This designation can be given if any portion of the county meets the D2 (severe drought) intensity for 8 consecutive weeks (Table 1) or if a higher intensity value is present for any length of time as reported in the USDM (USDA-FSA, 2017a). Upon the issuance of an emergency disaster designation, many relief programs become available to farmers and ranchers. Some of these will be discussed below.

Governing bodies have different policies and regulations, but in many cases the USDM can trigger government response. For example, federal, state, county, or municipal governments may designate fire restrictions in times of drought based on the USDM.

Available Programs

Livestock Forage Disaster Program (LFP)

For most states (Arizona being one of them), the Livestock Forage Disaster Program (LFP) is a USDA-FSA program issued through the 2014 Farm Bill and is designed to provide compensation to eligible livestock producers who have suffered grazing losses due to drought conditions during that county's normal grazing period. In Arizona, this grazing period varies by region or allotment but can be associated with the state's bi-modal (winter vs. summer) precipitation patterns, elevation, or public land agency permits and leases. Contact your local Cooperative Extension Agent or public land agency for information on grazing seasons and climate.

To be eligible for the LFP you must be a livestock producer who privately owns or leases grazing land or pastureland physically located in a county rated by the US Drought Monitor, and be within the normal grazing period. Assistance rates for the FLP are as follows:

> Enrollment for the LFP requires the producer provide a completed application for payment and required supporting documentation to their FSA office within 30 calendar days after the end of the calendar year in which grazing loss occurred. Producers should include a copy of the grower contract if they are a contract grower along with other supporting documents to determine eligibility. Supporting documents must include evidence of loss, current physical location of livestock in inventory, and evidence that grazing land or pastureland is owned or leased. Producers are also eligible for the LFP when a federal agency excluded the livestock producer from grazing normally permitted livestock on managed rangelands due to fire. (USDA FSA, 2017b).

For more detailed information on the LFP, please see the Livestock Forage Disaster Program Fact Sheet: https://www.fsa.usda.gov/Assets/USDA-FSA-Public/usdafiles/FactSheets/2018/livestock_forage_disaster_program-july2018.pdf

Table 1. Livestock Forage Disaster Program Payment Schedule. Note: the difference in the payment schedule between the two D3 & D4 payments is the length of time in each category.

Drought Rating	Abnormally Dry	Moderate Drought	Severe Drought	Extreme Drought	Extreme Drought	Exceptional Drought	Exceptional Drought
Amount of time during normal grazing period	N/A	N/A	At least 8 consecutive weeks	At any time	At least 4 weeks	At any time	4 weeks (not necessarily consecutive)
Assistance Payment	N/A	N/A	Equal to 1 monthly payment	Equal to 3 monthly payments	Equal to 4 monthly payments	Equal to 4 monthly payments	Equal to 5 monthly payments

Adapted from 2014 Farm Bill Fact Sheet: Livestock Forage Disaster Program. April, 2017.

Emergency Loan Program

The Emergency Loan Program is triggered when a natural disaster such as drought is designated or declared by an appropriate government entity. These loans help producers recover from production and physical losses due to natural disasters or quarantine. FSA loan requirements are different than those of other lenders where borrowers of FSA loans:

- must keep acceptable records
- operate in accordance with a farm/ranch plan they develop and agree to with local FSA staff, and
- may be required to participate in a financial management training program and obtain crop insurance.

To be eligible for an emergency loan, a farmer and/or rancher must own or operate land located in a county or contiguous county that has been designated or declared eligible by an appropriate government entity. Because these are loans, the eligible producer must have an acceptable credit history and are unable to receive credit from commercial sources. Collateral is required and the borrower must have repayment ability (USDA FSA, 2017b). Other eligibility requirements for farmers and/or ranchers include that they:

- be an established family farm operation with sufficient farming experience,
- are citizens or permanent residents of the US, and
- have suffered at least a 30% loss in crop production or a physical loss to livestock, livestock products, real estate, or chattel property.

Emergency loan funds may be used to:

- restore or replace essential property,
- pay all or part of production costs associated with the disaster year,
- pay essential family living expenses,
- reorganize the farming operation, and
- refinance certain debts.

For more detailed information on the Emergency Loan Program, please see the Emergency Loan Program Fact Sheet: https://www.fsa.usda.gov/Assets/USDA-FSA-Public/usdafiles/FactSheets/archived-fact-sheets/emergency_loan_program_oct2017.pdf

IRS Tax Deferral

There are two provisions in tax law that attempt to cushion producers from the consequences of adverse weather-related (e.g. drought) livestock sales, Involuntary Conversion and The One Year Deferral Rule. Both of these provisions apply only to those sales that are in excess of "normal sales" for the producer (Hobbs, 2016). Because these provisions for weather-related sales of livestock have different requirements, or whether these tax provisions will provide any benefit to a producer depends on a detailed analysis of the specific circumstances in each case (Post, 2012).

More detailed examples of each of these tax provisions can be found at: http://ruraltax.org/files-ou/Livestock_Sales.pdf

Involuntary Conversion

When a producer sells more draft, breeding, or dairy animals than normal due to weather-related conditions they may defer recognition of the gains for up to two years (Hobbs, 2016). The producer must replace the livestock sold or exchanged with livestock similar, or related in service or use, within two years after the year in which proceeds were received. For example, breeding livestock must be replaced with breeding livestock and not dairy livestock (Voss, 2017).

Electing to Defer the Gain

A producer can elect to defer the gain from the involuntary conversion sale by attaching a statement to their tax return providing evidence (e.g. USDM report) of the weather-related condition that caused the early sale. The statement needs to include the computation of the gain realized, the number and kind of livestock sold, and the number and kind of livestock that would have been sold under normal business practices.

- The election can be made at any time within the normal statute of limitations for the period in which you recognize the gain. It must occur before the expiration of the period in which the converted property must be replaced.
- If the election is filed but eligible replacement property is not acquired within the applicable replacement period (usually four years), the producer will have to file an amended return for the year in which the gain was originally realized.
- If animals are replaced, producers should include information with the return that shows the purchase date of the replacement livestock, the cost of the replacement livestock, and the number and kind of the replacement livestock.
- The election must be made in the return for the first tax year in which you realize any part of the gain from the sale.
- Sufficient records need to be maintained to support the non-recognition of gain.

If a partnership owns livestock and sells them, the election is the responsibility of the partnership (Voss, 2017).

The One-Year Deferral Rule

If drought or other weather-related conditions force farm or ranch taxpayers to dispose of more livestock than they would have sold in a normal business situation, they may choose to defer reporting the gain associated with the excess until the following taxable year. I.R.C. §451(e) (Voss, 2017). Livestock producers using the cash method of accounting can elect to defer for one tax year the income of certain livestock sold due to weather-related conditions. The area **must** be federally recognized and declared as eligible to receive federal assistance (Hobbs, 2016). The taxpayer's principal business must be farming/ranching in order to take advantage of this provision.

What if the livestock owner doesn't know which election would be his best choice at tax time? The IRS permits a "protective" election under I.R.C. §1033 for that tax year. This allows revoking an involuntary election and then filing amended returns for both tax years affected. The IRS code offers a number of options for taxpayers who make an election but fail to acquire replacement livestock in the required four-year period (Voss, 2017).

Consult your tax professional for further clarification in order to analyze and evaluate if these tax opportunities will be of benefit in a particular situation.

Summary

Impacts of a natural disaster such as drought can be severely detrimental to livestock operations and affect the ability to manage Arizona rangelands properly and sustainably. The resources provided above are available to producers, depending on eligibility, to relieve some of the economic hardships producers may face during times of tremendous need. Visit with your local Farm Service Agency representative for program and application details, your tax professional, or contact your Cooperative Extension office for more information.

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