

## Part III - Administrative, Procedural, and Miscellaneous

### Extension of Replacement Period for Livestock Sold on Account of Drought

Notice 2006-82

#### SECTION 1. PURPOSE

This notice provides guidance regarding the replacement period under § 1033(e) of the Internal Revenue Code for livestock sold on account of drought.

#### SECTION 2. BACKGROUND

##### .01 Nonrecognition of Gain on Involuntary Conversion of Livestock.

Section 1033(a) generally provides for nonrecognition of gain when property is involuntarily converted and replaced with property that is similar or related in service or use. Section 1033(e)(1) provides that a sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number that would be sold following the taxpayer's usual business practices is treated as an involuntary conversion if the livestock is sold or exchanged solely on account of drought, flood, or other weather-related conditions.

.02 Replacement Period. Section 1033(a)(2)(A) generally provides that gain from an involuntary conversion is recognized only to the extent the amount realized on the conversion exceeds the cost of replacement property purchased during the replacement period. If a sale or exchange of livestock is treated as an involuntary conversion under § 1033(e)(1) and is solely on account of drought,

flood, or other weather-related conditions that result in the area being designated as eligible for assistance by the federal government, § 1033(e)(2)(A) provides that the replacement period ends four years after the close of the first taxable year in which any part of the gain from the conversion is realized. Section 1033(e)(2)(B) provides that the Secretary may extend this replacement period on a regional basis for such additional time as the Secretary determines appropriate if the weather-related conditions that resulted in the area being designated as eligible for assistance by the federal government continue for more than three years. Section 1033(e)(2) is effective for any taxable year with respect to which the due date (without regard to extensions) for a taxpayer's return is after December 31, 2002.

### SECTION 3. EXTENSION OF REPLACEMENT PERIOD FOR PERSISTENT DROUGHT

.01 In General. If a sale or exchange of livestock is treated as an involuntary conversion on account of drought and the taxpayer's replacement period is determined under § 1033(e)(2)(A), the replacement period will be extended under § 1033(e)(2)(B) until the end of the taxpayer's first taxable year ending after the first drought-free year for the applicable region. For this purpose, the first drought-free year for the applicable region is the first 12-month period that--

(1) Ends on August 31;

(2) Ends in or after the last year of the taxpayer's 4-year replacement period determined under § 1033(e)(2)(A); and

(3) Does not include any weekly period for which exceptional, extreme, or severe drought is reported for any location in the applicable region.

.02 Applicable Region. The applicable region with respect to a sale or exchange of livestock on account of drought conditions is the county that experienced the drought conditions on account of which the livestock was sold or exchanged and all counties that are contiguous to that county.

.03 Exceptional, Extreme, or Severe Drought. (1) U.S. Drought Monitor Maps. A taxpayer may determine whether exceptional, extreme, or severe drought is reported for any location in the applicable region by reference to U.S. Drought Monitor maps produced by the National Drought Mitigation Center. In determining whether a 12-month period ending on August 31 of a calendar year includes any period for which exceptional, extreme, or severe drought is reported, all maps with dates before September 8 of that year and after August 31 of the preceding calendar year are taken into account. U.S. Drought Monitor maps are archived at <http://www.drought.unl.edu/dm/archive.html>.

(2) Publication of List of Drought Counties. Taxpayers can generally determine on the basis of a visual inspection of U.S. Drought Monitor maps whether exceptional, extreme, or severe drought is reported for all or part of a county. In some cases, however, on the borders of a drought zone, it may not be clear on the basis of a visual inspection whether a county is within or partly within the zone. Accordingly, the Internal Revenue Service, after consultation with the National Drought Mitigation Center, will publish in September of each year a list of counties for which exceptional, extreme, or severe drought was reported

during the preceding 12 months. Taxpayers may use this list instead of U.S. Drought Monitor Maps to determine whether a 12-month period ending on August 31 of a calendar year includes any period for which exceptional, extreme, or severe drought is reported for a location in the applicable region.

#### SECTION 4. EXAMPLE

The following example illustrates the application of the rules in this notice. Drought conditions and designations of eligibility for federal assistance are described in this example solely for illustrative purposes and are not intended to reflect actual conditions and designations.

Example. (i) Taxpayer A, a calendar year taxpayer, raises cattle in Keith County, Nebraska. In 2002, all of A's cattle held for breeding purposes are sold solely on account of drought conditions in Keith County. Under A's normal business practices, only 25 percent of A's cattle held for breeding purposes would have been sold in 2002. In 2003, the Secretary of Agriculture designates Keith County as eligible for federal assistance on account of the drought conditions.

(ii) Under § 1033(e)(1), the sale of 75 percent of the cattle held for breeding purposes is treated as an involuntary conversion. Section 1033(a) provides that the gain from this portion of A's sale is not recognized except to the extent it exceeds the cost of replacement property (property that is related in service or use) purchased during the replacement period. Because the Secretary of Agriculture has designated Keith County as being eligible for federal assistance on account of the drought conditions, A's replacement period is determined under § 1033(e)(2)(A) and ends on December 31, 2006.

(iii) Under § 1033(e)(2) and this notice, A's replacement period is extended until the end of A's first taxable year ending after the first drought-free year for the applicable region. For this purpose, the applicable region is the county that experienced the drought conditions on account of which the livestock was sold (Keith County) and all counties contiguous to Keith County (Deuel, Garden, Arthur, McPherson, Lincoln, and Perkins Counties, Nebraska, and Sedgwick County, Colorado). Sedgwick County is contiguous even though it is in a different state and touches Keith County only at Keith County's southwest corner.

(iv) For the 12-month period ending on August 31, 2006, severe drought conditions are reported on U.S. Drought Monitor maps for all counties in the applicable region, and all of those counties are included on the list published by the IRS. For the 12-month period ending on August 31, 2007, the only drought conditions reported for the applicable region on U.S. Drought Monitor maps are severe drought conditions for Sedgwick County for the first week in September 2006. A is unable to determine from the maps whether drought conditions have been reported for the applicable region, but the list published by the IRS for the 12-month period ending on August 31, 2007, includes Sedgwick County. For the 12-month period ending August 31, 2008, U.S. Drought Monitor maps do not report drought conditions for any county in the applicable region and none of the counties are included on the list published by the IRS.

(v) Neither the 12-month period ending on August 31, 2006, nor the 12-month period ending on August 31, 2007, is a drought-free year for the applicable region because, in each of the 12-month periods, severe drought conditions have been reported for at least one county in the applicable region for a part of the 12-month period. Accordingly, the 12-month period ending on August 31, 2008, is the first drought-free year for the applicable region. Under § 1033(e)(2) and this notice, A's replacement period is extended through December 31, 2008 (the last day of A's first taxable year ending after the first drought-free year for the applicable region).

#### SECTION 5. EFFECTIVE DATE

This notice applies to taxable years ending after September 25, 2006.

#### SECTION 6. DRAFTING INFORMATION

The principal author of this notice is Jeffrey Marshall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Marshall at (202) 622-7287 (not a toll-free call).