Reporting Cattle Operation Income to the IRS

► Understanding the tax implications of selling cattle is crucial for a cattle producer. The example and completed tax forms provided here can serve as a guide to producers in their operations.

A hypothetical cattle operation has been devised to explain the income tax impact on cattle operations. The numbers reflect the revenue, expenses incurred to generate that income, fixed assets required to support the operation, and labor to manage the operation.

In this scenario, Ken is the sole member of Andalusia Cattle LLC. He has an off-farm job as his primary income and a herd of cows he manages on the side. The herd typically consists of thirty-five brood cows, two herd bulls, and thirty calves (half bulls and half heifers).

In 2021, Ken sold twenty-eight calves, two brood cows, and one bull. He kept two heifers for breeding stock and purchased two bred heifers for $1,831 each.

Ken purchased two bred heifers in 2020 for $1,800 each. He must allocate the fair market value of the cow to the cow and the remainder to the calf (see Gamble v. Commissioner, 68 T.C. 800 and Revenue Ruling 86-24). He allocated $1,550 of the purchase price to the cow and the remaining $250 to the calf.

Raised stock and purchased stock must be accounted for separately. The fifteen raised steers averaged 550 pounds and sold for $165/cwt or $13,612.50. The thirteen heifers averaged 500 pounds and sold for $143/cwt or $9,295.00. The total revenue for the raised calves was $22,907.50. The two calves from the bred heifers purchased in 2020 weighed 600 pounds each and sold for a total of 1,980.00.

Schedule F, Part I Farm Income—Cash Method

See figure 1, Schedule F for Andalusia Cattle LLC. The purchased livestock are reported on line 1; this includes sales revenue of $1,980 on line 1a, the cost or basis of $500 on line 1b, and the net, $1,480, on line 1c.

Ken is allowed to depreciate the cost of the bred heifers bought in 2020, but not the cost of the calves in that year. For livestock purchased for resale, the purchase price must be deducted in the year of sale, not the year of purchase (Treas. Reg. §1.61-4(a)). Ken sold the two calves for $1,980 and deducted the allocated basis of $500 for the two calves for a net gain of $1,480 on the two calves from the bred heifers.

The sale of the raised livestock is reported on line 2. Raised livestock do not have a basis. The expenses to raise the calves are deducted in the year they are incurred and do not create a basis in the cattle. The line 2 amount of revenue is $22,908, and the gross Schedule F income for the cattle operation is $24,388.

The sale of livestock held for sale (as opposed to holding for breeding stock) produces ordinary income, which is subject to self-employment tax. For this example, expenses were half of the sales income from the 30 calves, 4 brood cows, and the bull or $14,946, leaving a Schedule F profit of $9,442.

Since Ken's taxable income is greater than $19,900 and less than $81,050 (see figure 7), his marginal income tax rate is 12 percent. This means the sale of the cows generated an income tax liability of $1,133. Ken also owes self-employment tax on 92.35 percent of the net farm profit at the 15.3 percent rate (IRC Section 1401), or $1,334 of employment tax liability.

Form 8995: Qualified Business Income Deduction Simplified Computation

The Tax Cuts and Jobs Act reduced the income tax owed by corporations to 21 percent. This did not apply, however, to pass-through entities (general partnerships, limited partnerships, limited liability companies, and S-corporations) and sole proprietorships. In these cases, income tax liability was passed on to the individual owners, who included the amount on their individual returns.

Since the income tax rate of pass-through business owners was not decreased, Congress introduced the Qualified Business Income Deduction (QBID) to reduce the income tax effect on pass-through entities. The deduction is generally the lesser of 20 percent of the business income or 20 percent of the taxable income.

In Ken's case, the QBID is $1,755 (see figure 2). Half the self-employment tax reduces the net farm income before computing the deduction. The $1,755 deduction results in income tax savings of $211.

Combining the income tax, self-employment tax, and QBID, the tax impact of the Schedule F operation is a net payment of $2,256, but Ken sold an additional four animals.

Property Used in the Trade or Business or Involuntary Conversion

The sale of the brood cows and the bull is not reported on Schedule F because they were not held for sale but for breeding. As such, they are property used in the trade or business. Code Section 1231, titled "Property Used in the Trade or Business or Involuntary Conversion," allows any gains on the disposition of business property to be reported as capital gains, but any losses are deducted as ordinary losses. Property used in the trade or business includes cattle and horses, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes and held for 24 months or more (Sec. 1231(b)(3)(A)).

"There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear . . . of property used in the trade or business, or of property held for the production of income" (Sec. 167). If depreciable property is disposed of, the amount realized that exceeds the adjusted basis up to the purchase price is treated as ordinary income" (Sec. 1245 (a)(1)).

Ken sold four brood cows in 2021. Three of the cows were raised and held for breeding; therefore, they are considered Section 1231 property. Since the cows were held for more than 24 months and there was a gain on the sale, it qualifies for long-term capital gains treatment.

Part I	Farm Income - Cash Method. Complete Parts I and II. (Accrual method. Complete Parts II and III, and Part I, line 9.)						
1a	Sales of purchased livestock and other resale items (see instructions)			1a	1,980		
b	Cost or other basis of purchased livestock or other items reported on line 1a			1b	500		
c	Subtract line 1b from line 1a					1c	1,480
2	Sales of livestock, produce, grains, and other products you raised					2	22,908
3a	Cooperative distributions (Form(s) 1099-PATR)	3a		3b	Taxable amount	3b	
4a	Agricultural program payments (see instructions)	4a		4b	Taxable amount	4b	
5a	Commodity Credit Corporation (CCC) loans reported under election					5a	
b	CCC loans forfeited	5b		5c	Taxable amount	5c	
6	Crop insurance proceeds and federal crop disaster payments (see instructions):						
a	Amount received in 2021	6a		6b	Taxable amount	6b	
c	If election to defer to 2022 is attached, check here ▶ ☐			6d	Amount deferred from 2020	6d	
7	Custom hire (machine work) income					7	
8	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)					8	
9	**Gross Income.** Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50. See instructions ▶					9	24,388

Figure 1. Schedule F Part I Farm Income—Cash Method for Andalusia Cattle LLC

2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2	8,775		
3	Qualified business net (loss) carryforward from the prior year	3	( )		
4	Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0-	4	8,775		
5	Qualified business income component. Multiply line 4 by 20% (0.20)			5	1,755
6	Qualified REIT dividends and publicly traded partnership (PTP) income or (loss) (see instructions)	6	0		
7	Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year	7	( )		
8	Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0-	8	0		
9	REIT and PTP component. Multiply line 8 by 20% (0.20)			9	0
10	Qualified business income deduction before the income limitation. Add lines 5 and 9			10	1,755
11	Taxable income before qualified business income deduction (see instructions)	11	72,571		
12	Net capital gain (see instructions)	12	2,880		
13	Subtract line 12 from line 11. If zero or less, enter -0-	13	69,691		
14	Income limitation. Multiply line 13 by 20% (0.20)			14	13,938
15	Qualified business income deduction. Enter the smaller of line 10 or line 14. Also enter this amount on the applicable line of your return (see instructions) ▶			15	1,755

Figure 2. Form 8995 Qualified Business Income Deduction Simplified Computation

Form 4797 Part I

Cull cows were selling for $80/cwt and averaged 1,200 pounds each for a sale price of $960 per cow. The sale of the three raised cows was reported on Form 4797, Part I (see figure 3).

Since the cows were raised, there was no basis and therefore no depreciation. The revenue from the three raised cull cows was $2,880.

Note in line 8 that any net Section 1231 losses from the prior 5 years must be deducted from the long-term capital gains. The instructions on line 9 indicate that the revenue is to be carried to Schedule D line 11: Gain from Form 4797.

Form 4797 Part III

One of Ken's cull cows was a purchased bred heifer. He had allocated $1,420 to the heifer when he bought it in 2012. Considered a 5-year property, this cow is now fully depreciated.

Since purchased cattle are considered Section 1245 property, Ken must recapture the depreciation he previously claimed. The cow sold for $960, but Ken is claiming $1,420 of depreciation. He does not have to recognize more than he realized, therefore he reports $960 on the form and does not have to recognize the additional $460 of depreciation (see figure 4).

Ken also sold a bull he purchased in 2018. If Ken had used ordinary depreciation rates, he would have deducted 20 percent of the purchase price in 2018, 32 percent in 2019, and 19.2 percent in 2020. He would not claim depreciation in the year of disposition.

Ken could have elected to use Section 179 treatment or bonus depreciation to write off the cost of the bull over a shorter period. In figure 4, note that line 22 states depreciation allowed or allowable. This means that even if you do not claim the allowable deduction, you still must report it and pay income tax on the amount at ordinary rates. In this example, under Property B, Ken has a taxable gain of $656. If he had fully depreciated the bull, his gain would have been $1,664.

Form 4797 Summary of Part III Gain

The sales results are summarized in Summary of Part III Gains (figure 5). The total amount realized ($1,616) is reported on line 30. This amount is repeated on line 31 as the depreciation recapture. Since the $2,880 (figure 3) is gain from the sale of business property, and the $1,616 is depreciation recapture, they are not subject to self-employment tax.

Form 4797 Part II Ordinary Gains and Losses

Form 4797 Part II (figure 6) is used to report short-term capital gains that are taxed at ordinary rates, not capital gains rates. The $1,616 of depreciation recapture is reported on line 13 and part of the total on line 18. The instructions in line 18b indicate that the revenue is to be reported on Schedule 1 of Form 1040.

Part I **Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft - Most Property Held More Than 1 Year** (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
Brood Cows (3)	01-01-2012	06-23-2021	2,880			2,880

3	Gain, if any, from Form 4684, line 39	3	
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37	4	
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824	5	
6	Gain, if any, from line 32, from other than casualty or theft	6	0
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows	7	2,880
	Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.		
	Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.		
8	Nonrecaptured net section 1231 losses from prior years. See instructions	8	
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions	9	

Figure 3. Andalusia Cattle Company LLC Form 4797 Part I

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Part III **Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255** (see instructions)

19 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A Brood Cow	01-01-2012	07-23-2021
B Bull	04-20-2018	07-23-2021
C		
D		

These columns relate to the properties on lines 19A through 19D. ▶		Property A	Property B	Property C	Property D
20 Gross sales price (**Note:** *See line 1a before completing.*)	20	960	1,664		
21 Cost or other basis plus expense of sale	21	1,420	3,500		
22 Depreciation (or depletion) allowed or allowable	22	1,420	2,492		
23 Adjusted basis. Subtract line 22 from line 21	23	0	1,008		
24 Total gain. Subtract line 23 from line 20	24	960	656		
25 **If section 1245 property:**					
a Depreciation allowed or allowable from line 22	25a	1,420	2,492		
b Enter the **smaller** of line 24 or 25a	25b	960	656		

Figure 4. Andalusia Cattle Company LLC Form 4797 Part III

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30	Total gains for all properties. Add property columns A through D, line 24	30	1,616
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	1,616
32	Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	32	0

Figure 5. Andalusia Cattle LLC Form 4797 Summary of Part III Gain

Part II	Ordinary Gains and Losses (see instructions)		
10	Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):		
11	Loss, if any, from line 7	11	( )
12	Gain, if any, from line 7 or amount from line 8, if applicable	12	
13	Gain, if any, from line 31	13	1,616
14	Net gain or (loss) from Form 4684, lines 31 and 38a	14	
15	Ordinary gain from installment sales from Form 6252, line 25 or 36	15	
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824	16	
17	Combine lines 10 through 16	17	1,616
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.		
a	If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions	18a	
b	Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4	18b	1,616

Figure 6. Andalusia Cattle Company LLC Form 4797 Part II Ordinary Gains and Losses

Form 1040

Capital gains rates for married individuals filing jointly in 2021 were 0 percent for taxpayers with taxable income of $80,800 or less, 15 percent for taxpayers with taxable income between $80,801 and $501,600, and 20 percent for taxable income greater than $501,600.

In this example, Ken earned $50,000 in his off-farm job, and his wife earned $35,000 from her job. They have two children and are using married filing joint status and standard deductions.

Lines 1 through 15 of their form 1040 are shown in figure 7. Line 1 reports their combined off-farm income of $85,000. Line 7 is the sale of the three heifers from schedule D. Line 8 is their other income, which consists of the $1,616 from depreciation recapture and $9,442 Schedule F net farm income. Line 10 is the deduction for half of the self-employment tax. After deductions, their taxable income is $70,816.

The capital gain is included in Ken's taxable income, but the tax tables are not used to calculate the income tax. Because their taxable income is less than $80,800, the income tax rate on the $2,880 of long-term capital gains is 0 percent. See figure 8 for the calculations. Line 9 shows the $2,880 is taxed at 0 percent.

Anytime you have long-term capital gains, complete the worksheet to determine the amount taxed at 0, 15, and 20 percent. Even if your taxable income is greater than $80,800, some of your gains may be taxed at 0 percent.

Summary

Ken's cattle operation generated $30,391 of revenue from the sale of thirty calves, four brood cows, and one bull. Expenses were $14,946. His tax bill was $2,256 for the calf operation, $194 for depreciation recapture on the sale of the purchased heifer and bull, $0 for the sale of the three cull cows, and a credit of $80 for the reduction in taxable income due to half of the self-employment tax. The total federal tax was $2,370.

Alabama has a single income tax rate for individuals and does not recognize capital gains. Ken's Alabama farm income was $13,938, which was taxed at 5 percent or $697. The total tax bill was $3,067, leaving him with $12,378.

If Ken and his wife's taxable income from off-farm jobs had exceeded $81,050, the federal marginal tax rate would have been 22 percent instead of 12 percent, and the amount of income tax owed to the IRS would have almost doubled. The Alabama tax would have been at the same rate.

The example of Andalusia Cattle LLC is for illustrative purposes only and may not reflect your individual operation. The income tax calculations and forms were generated using Drake Tax Software. This article does not constitute tax advice but only general knowledge of the impact of income tax on selling cattle. We suggest that you consult with an income tax professional before conducting a significant sale.

Attach Sch. B if required.	1	Wages, salaries, tips, etc. Attach Form(s) W-2				1	85,000
	2a	Tax-exempt interest	2a		b Taxable interest	2b	
	3a	Qualified dividends	3a		b Ordinary dividends	3b	
	4a	IRA distributions	4a		b Taxable amount	4b	
	5a	Pensions and annuities	5a		b Taxable amount	5b	
Standard Deduction for-	6a	Social security benefits	6a		b Taxable amount	6b	
	7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐				7	2,880
	8	Other income from Schedule 1, line 10				8	11,058
	9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶				9	98,938
	10	Adjustments to income from Schedule 1, line 26				10	667
	11	Subtract line 10 from line 9. This is your **adjusted gross income** ▶				11	98,271
	12a	**Standard deduction or itemized deductions** (from Schedule A)		12a	25,100		
	b	Charitable contributions if you take the standard deduction (see instructions)		12b	600		
	c	Add lines 12a and 12b				12c	25,700
	13	Qualified business income deduction from Form 8995 or Form 8995-A				13	1,755
	14	Add lines 12c and 13				14	27,455
	15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-				15	70,816

- Single or Married filing separately, $12,550
- Married filing jointly or Qualifying widow(er), $25,100
- Head of household, $18,800
- If you checked any box under *Standard Deduction*, see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Form **1040** (2021)

EEA

Figure 7. Form 1040 for Ken and Susan Smith

1. Enter the amount from Form 1040 or 1040-SR, line 15. However, if you are filing Form 2555 (relating to foreign earned income), enter the amount from line 3 of the Foreign Earned Income Tax Worksheet	1.	70,816
2. Enter the amount from Form 1040 or 1040-SR, line 3a*	2.	
3. Are you filing Schedule D?* ☒ **Yes.** Enter the **smaller** of line 15 or 16 of Schedule D. If either line 15 or 16 is blank or a loss, enter -0-. ☐ **No.** Enter the amount from Form 1040 or 1040-SR, line 7.	3.	2,880
4. Add lines 2 and 3	4.	2,880
5. Subtract line 4 from line 1. If zero or less, enter -0-	5.	67,936
6. Enter: $40,400 if single or married filing separately, $80,800 if married filing jointly or qualifying widow(er), $54,100 if head of household.	6.	80,800
7. Enter the smaller of line 1 or line 6	7.	70,816
8. Enter the smaller of line 5 or line 7	8.	67,936
9. Subtract line 8 from line 7. This amount is taxed at 0%	9.	2,880

Figure 8. Form 1040 calculations

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