

CROP INSURANCE AND DISASTER PAYMENTS

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Some crop losses due to adverse weather conditions were compensated by insurance or federal disaster payments. Several income tax rules allow preferential treatment of gains and losses realized as a result of these weather conditions.

Generally, farmers who use cash accounting must report payments in the year they receive the payments. This method can cause a bunching of income for farmers who normally sell their crop the year after it is harvested if a crop is lost due to a natural disaster because they may receive an insurance or disaster payment for that crop in the year it would have been harvested. Thus, they receive the proceeds from the sale of the previous year's crop as well as the insurance or disaster payment for the current year's crop in the same tax year.

Exception for Cash-Basis Farmers

An exception to the general rule that payments must be reported in the year they are received allows a cash-basis farmer to postpone reporting a crop loss payment by 1 year. (It does not allow the taxpayer to accelerate reporting the payment if the payment is received the year after a loss.)

Generally, these rules apply when crops cannot be planted or are damaged or destroyed by natural disaster such as a drought or flood.

Qualifying for the Exception

To qualify for the exception, a taxpayer must use the cash method of accounting and must be able to show that, under the taxpayer's normal business practice, the income from the crop would have been reported **in a year following the year of the receipt of the payment.**

Making the Election

Taxpayers who qualify for this exception have the option of reporting the payment as income in the year it is received or as income in the following year. The election to postpone reporting the payment as income can be made on the original return or an amended return for the tax year [Treas. Reg. § 1.451-6(b)(1)]. The election covers *all crops* from a farm. If a farmer has more than one farming business, a separate election must be made for each farming business. For purposes of this provision, separate businesses are defined as those for which the taxpayer keeps separate books and is allowed to use different methods of accounting. In general, that requires the businesses to be separate and distinct.

Example 1: Insurance and Disaster Payments

In Year 1, Clay Fields received \$8,000 of crop insurance proceeds due to hail damage on his wheat crop and received \$14,000 of disaster payments as a result of drought damage to his corn crop. He normally sells both of these crops in the year after they are harvested.

Question 1

Can Clay elect to include in income the crop insurance proceeds for his wheat and defer the disaster payments for his corn, because one type of payment is crop insurance and the other type of payment is a disaster payment?

Answer 1

No, the crop insurance proceeds and the disaster payments must be aggregated in determining whether to defer the income reporting or to include the payments in current-year income. Crop disaster payments are specifically identified as equivalent to crop insurance proceeds, and both types of payments must be reported in a consistent manner. Therefore, Clay must decide whether to report the entire \$22,000 (\$8,000 + \$14,000) as income in Year 1 or defer both payments to Year 2, assuming he meets the requirement of normally selling the crops in the following year.

Question 2

Assume that Clay received the \$8,000 of crop insurance proceeds for the wheat loss in his sole proprietorship grain farm and received the \$14,000 of disaster payments for drought damage to corn grown by a farming partnership in which Clay is a 50% partner. The wheat farm and the corn farm are separate farming businesses and keep separate records. Can Clay elect to include in income the \$8,000 of crop insurance proceeds for his wheat, while the farm partnership elects to defer the disaster payment received for its corn?

Answer 2

Yes, the two separate farming operations in which Clay participates do not have to make the same election. If a taxpayer has more than one farming business, a separate election is made for each business.

Statement

An election to defer recognition of income from crop loss payments must be attached to the return (or amended return) for the tax year in which the payment was received. The statement must include

1. The name and address of the taxpayer
2. A declaration that the taxpayer is making an election under I.R.C. § 451(d)
3. Identification of the specific crop or crops destroyed or damaged
4. A declaration that, under the taxpayer's normal business practice, the income derived from the destroyed or damaged crops would have been included in gross income for a tax year following the tax year of the destruction or damage
5. The cause of destruction or damage of crops and the date or dates on which the destruction or damage occurred
6. The total amount of payments received from insurance carriers, itemized for each specific crop and showing the date each payment was received

7. The name(s) of the insurance carrier or carriers making the payment

Example 2: Income Postponed

Daisy Petal normally sells her soybean and cotton crops in the year after they are produced. In Year 1 her soybean and cotton crops were damaged by hail. She had insurance to cover the loss and received a \$15,000 payment for soybeans and \$21,000 payment for cotton from the insurance company.

Daisy can postpone reporting the \$36,000 of income by attaching the statement shown in Figure 1 to her Year 1 return. She then reports the \$36,000 on line 6a of her Year 1 Schedule F (Form 1040), Profit or Loss from Farming, but she does not include it on line 6b. In Year 2, she will include the \$36,000 on line 6b of her Schedule F (Form 1040).

FIGURE 1: ELECTION TO POSTPONE RECOGNITION OF INCOME

<p>Election under I.R.C. § 451(d) to Postpone Recognition of Crop Insurance Proceeds Daisy Petal 000-00-0001 Route 2, Box 2 Bitterweed, MS 38000</p>					
<p>Daisy Petal elects to postpone the recognition of the following crop insurance proceeds. The crops for which these proceeds were received would have been sold in Year 2 under her normal business practice.</p>					

Crop Destroyed or Damaged	Cause	Date of Destruction or Damage	Payment Received	Date of Payment	Insurance Carrier
Soybeans	Hail	7-10-Year 1	\$15,000	10-15-Year 1	Crops Ins., Inc.
Cotton	Hail	7-10-Year 1	\$21,000	10-15-Year 1	Crops Ins., Inc.

Observation
Reporting Prior Year's Payments
 Farmers who deferred crop insurance and disaster payments from Year 1 to Year 2 must report those payments on line 6b of the Year 1 Schedule F (Form 1040), Profit or Loss from Farming.

Crop Revenue Coverage

Some farmers received compensation under Crop Revenue Coverage (CRC) policies they purchased from the Federal Crop Insurance Corporation. These payments are based on the price, as well as the quantity and quality, of the commodity produced. Only the payment for destruction or damage is eligible for the I.R.C. § 451(d) deferral (Notice 89-55, 1989-1 C.B. 696). Therefore, a farmer who receives compensation from a CRC policy must determine the portion of the payment that is due to crop destruction or damage rather than due to a reduced market price.