



Crop Insurance: Tax Rules and Issues for 2012

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Generally, crop insurance proceeds received by a farmer using the cash method of accounting must be reported in the year in which the insurance proceeds are received. However, both the farmer and insurance payment qualify, the farmer can elect to postpone the reporting of the crop insurance payment until the following year.¹

Qualifying Farmer

To qualify for the election, the farmer must:

- Use the cash method of accounting for tax purposes
- Receive the insurance payment in the same tax year in which the crop damage occurred, and
- Show under normal business practices, the farmer would not have included the income from more than 50% of the damaged crops until the following year²

If the farmer does not receive the insurance payment until the year following the year of crop damage, the farmer must include the insurance payment in the year received.

Example 1. Henrietta is a corn producer. She uses the cash method of accounting. She typically sells her corn each year in late October or early November after harvesting. She reports the income from crop sales in the same year as the harvest. This has been her practice in past years. In 2012, her crop suffers severe drought damage. She receives her crop insurance payment in November, 2012. Because Henrietta's normal business practice is to report the income from her corn in the same year it is received, she is not eligible to make the election to defer the reporting of the crop insurance payment until 2013. She must report the insurance payment in 2012 because this is the year in which she normally would have reported the crop sales proceeds for her corn.

Example 2. Use the same facts as in Example 1, but Henrietta doesn't receive the crop insurance payment until early 2013. Henrietta reports the insurance payment amount on her 2013 tax return, even though the payment was made in connection with the destruction of her 2012 corn crop. She is not able to defer reporting the crop insurance payment until 2014.

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Qualified Payments

The type of insurance proceeds received must qualify for the election. Generally, federal payments received by the farmer will qualify if those payments are received:

- Because of destruction or damage to crops due to flood, drought or other natural disaster, or
- Because of a natural disaster that prevents the farmer from planting crops³

IRS guidance points out that federal payments made to the farmer under the Agricultural Act of 1949,⁴ Title II of the Disaster Assistance Act of 1988⁵ and Title I of the Disaster Assistance Act of 1989⁶ will qualify for the deferral election.

However, IRS Notice 89-55 makes it clear that in order for a payment to be received by the farmer because of “destruction of or damage to crops” the farmer must suffer an actual loss. Notice 89-55 further states that insurance payments made to the farmer without regard to actual losses of the farmer, such as making a payment in the event that certain weather conditions do not occur, do not qualify as payments made because of “destruction of or damage to crops” and therefore, will not qualify for the deferral election.

Revenue protection insurance, for example, guarantees the farmer a particular level of revenue, with regard to actual market prices and the farmer's yield. Payments are not based by direct reference to any actual loss to the farmer. While an examination of the actual policy is advisable to determine if a policy payment will partially or entirely qualify, generally any type of crop insurance policy that guarantees a revenue or income level to the farmer will provide payments that may not entirely qualify for the deferral election. The following types of policies generally fall into this category:

- Revenue Protection (RP)
- Revenue Protection with Harvest Price Exclusion (RP-HPE)
- Group Risk Income Protection (GRIP)

Other types of crop insurance make payments based on a reference to the particular farmer's actual yield. A policy that makes payments solely based on a direct reference to the covered farmer's actual yield will make payments that will likely qualify for the deferral election. It is likely that the IRS will consider such insurance payments to be made because of an actual loss to the farmer because of destruction or damage to crops. However, variants of this type of “pure yield” policy may make payments to the farmer that may not qualify, in whole or in part. Policies generally falling into this category include Group Risk Plan (GRP) policies which make payments based on county-wide crop losses instead of the covered farmer's actual yield. Yield-based policies which make payments based on a combination of the farmer's yield and some price or income guarantee may likewise not entirely qualify for deferral.

Proper tax advice is essential in this area in order to determine how much of a farmer's 2012 crop insurance payment qualifies for deferral to the 2013 tax year. Farmers who receive crop insurance payments in connection with the destruction or damage to crops in 2012 should bring a copy of their crop insurance policy to their tax preparer along with a copy of any calculations or other information the insurance company has provided in respect of the amount of payment that may qualify for deferral. This will allow the tax preparer to properly allocate and report the payment for 2012 and/or 2013. It is possible to have a payment partially qualify for deferral with the remaining amount reportable in the current year.

The “All or Nothing” Rule

A final rule to bear in mind if a deferral election is made in connection with crop insurance payments is that the election covers all the crops from a single trade or business of the farmer.⁷ If a farmer that receives a qualifying crop insurance payment during 2012 in connection with destruction or damage to two or more crops from a single farming trade or business must make the election to defer all the crop insurance payments until 2013 or not make the election at all and report all of the payments in 2012. However, if different crops are grown in separate farming trades or businesses, a separate election may be made for each.

Example 3. Jerry owns a farm that he operates as a sole proprietorship that produces wheat. He also

owns another nearby farm that produces corn. He operates both farms as one farming trade or business. His records for both farms are kept on a combined basis and the income or loss from both farms is combined on one Schedule F each year. In 2012, severe drought conditions destroyed the wheat and the corn. He received qualifying crop insurance payments which qualify to be deferred to 2013. Jerry can make the deferral election for all of the proceeds and report the proceeds in 2013. Conversely, he can report all the insurance proceeds in 2012 without making the election. He must treat all of the insurance proceeds from the wheat and corn in the same way because he operated the farms as one farming trade or business.

Example 4. Use the same facts as Example 4, except Jerry operates the wheat farm and the corn farm as separate farming businesses. He maintains separate records for each farm and the activity from each farm is reported on separate Schedule F forms each year. He treats them as separate and distinct farming operations. He receives qualifying crop insurance payments in 2012 in respect of drought losses to the wheat and the corn. Because Jerry operated the wheat and corn farms as separate businesses, he can choose whether or not to make separate elections on the insurance payments in respect of the wheat and corn losses and choose which payment to defer until 2013 and which to report in 2012. If Jerry wishes to elect to have the tax reporting of both the wheat insurance payment and the corn insurance payment deferred until 2013, he must make a separate election for each.

How to Make the Election

For crop damage and qualifying crop insurance payments that take place in the 2012 tax year, the farmer can make the deferral election by attaching a statement to the 2012 tax return (or amended return) with the following information:

- The farmer's name and address
- A statement that the election is being made under Internal Revenue Code §451(d) and Treasury Regulation §1.451-6
- A description of the specific crop(s) damaged or destroyed
- A statement that under the farmer's normal business practice the income from the destroyed or damaged crops would not have been included in the farmer's income until 2013
- A description of the cause of damage and the date it occurred
- An indication of the total amount and the date of each insurance or disaster payments received, itemized on a crop-by-crop basis, and
- The name of the insurance companies that the payment came from⁸

This 2012 election to defer the reporting of insurance proceeds is effective for the 2012 tax year only. A separate election is necessary for each tax year that the farmer wishes to defer the reporting of qualifying insurance proceeds.

Notes

¹ IRC §451(d).

² See Rev. Rul. 74-145, 1974-1 CB 113.

³ Treas. Reg. §1.451-6(a)(1).

⁴ IRS Notice 89-55, 1989-1 CB 698.

⁵ Ibid

⁶ IRS Notice 90-28, 1990-1 CB 339.

⁷ Treas. Reg. §1.451-6.

⁸ Treas. Reg. §1.451-6(b)(1).