Because of the wet spring, many Midwest farmers are considering whether to apply for prevented planting payments from their crop insurance carrier. This is making the farmers wonder if the prevented planting payments qualify for a tax deferral.

Note. See Gary Schnitkey's article, “Prevented and Late Planting Provisions in Crop Insurance” here.

To answer the deferral question, you only need to go as far as the Internal Revenue Service Publication 225, Farmer’s Tax Guide found at http://www.irs.gov/pub/irs-pdf/p225.pdf. Crop insurance proceeds must be included in gross farm income if they are the result of crop damage. Pub. 225 tells us, “They are usually included in the year the payments are received from the federal government as a result of destruction or damage to crops, or the inability to plant crops, because of drought, flood, or any other natural disaster.”

However, taxpayers can elect to defer the reporting of crop insurance payments until the following year if the following conditions are met.

1. The farmer must use the cash method of accounting.
2. The farmer receives the crop insurance proceeds in the same year the crops are damaged.
3. The farmer shows that under normal business practice he would have included income from the damaged crops in any year following the year the damage occurred.

Deferring a 2011 payment until 2012 requires the farmer to make an election on the 2011 return. The proceeds will be reported on line 8a of Schedule F but not reported on line 8b. The farmer must check the box located on line 8c and attach a statement to the return. The statement must include the following information:

1. A statement they are making an election under section 451(d) of the Internal Revenue Code and Regulations section 1.451-6.
2. The specific crop or crops destroyed or damaged.
3. A statement that under normal business practice they would have included income from the destroyed or damaged crops in gross income for a tax year following the year the crops were
destroyed or damaged.
4. The cause of the destruction or damage and the date or dates it occurred.
5. The total payments they received from insurance carriers, itemized for each specific crop, and the
date they received each payment.
6. The name of each insurance carrier from whom they received payments.

In a 2008 tax court case, Nelson v. Commissioner, U.S. Tax Court, T.C. No. 5, (Feb.28, 2008), both the
court and the IRS agreed the farmer must have deferred more than 50% of the current crop income into
the following year.

A farmer only needs to make one election for each single trade or business. For example, if they farm
both as an individual and a partnership and each business receives crop insurance payments, a separate
election must be made for each business. Once an election is made for the year, it is irrevocable for that
year unless revocation is approved by the IRS.

There are some cautions. If a taxpayer farms in more than one location as a single business and receives
crop insurance payments in both locations, he must either defer all of the payments or none of the
payments. Unlike other planning techniques, this is not a way to balance income between two years. The
purpose is to prevent farmers that store the 2010 crop and sell it in 2011 and then receive insurance
payments on the 2011 crop from having to report the income from two year’s crop in 2011.

If a farmer receives crop insurance for more than one crop, for example corn and soybeans, he must
make an election for each crop.