Crop insurance proceeds: Can I defer?

Growers must meet specific conditions to defer 2012 crop insurance income to their 2013 returns.

Because of this year's drought, many producers are reviewing their crop insurance options. Considerations may range from discussing their 2013 policy options to asking what tax-planning provisions are available for them with the 2012 proceeds. This article will focus on the tax aspect of deferring the crop insurance proceeds and discuss the "Can I defer?" question. That depends on various factors ranging from when you received the check to what type of crop insurance policy you purchased.

To begin, all crop insurance proceeds you receive will be reported as income on your tax return in the year received. However, if you elect to defer the proceeds, they won't be included in your taxable income.

For deferral purposes, crop insurance payments include crop disaster payments received as the result of destruction of or damage to crops. Also included are payments for the inability to plant crops because of drought, flood or any other natural disaster as well as payment for loss caused by those disasters.

A list of requirements

You can defer reporting crop insurance proceeds as taxable income until the year following the damage if you meet all of the following conditions:

- You use the cash method of accounting.
- You receive the crop insurance proceeds in the same year that the crops were damaged.
- You can show that, under normal business practice, you would have included income from the damaged crops in any tax year following the year the damage occurred. **Note:** On this point, the taxpayer must establish a history of reporting more than 50 percent of the crop sales in the subsequent year. If multiple crops are involved, the 50-percent test must be satisfied with respect to each crop.

Points to note

Several other "key" reminders for crop insurance are:

- The elections cover all crops in the "farming" business (Schedule F). You cannot elect to defer only corn insurance and not soybeans.
- If you have multiple entities in the "farming" business, each must make its own elections. In this case, 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.

Editor's note: Kent Vickre and Dwight Raab write a tax and finance column for each issue of Pioneer GrowingPoint® *magazine. Vickre is the state coordinator of the Iowa Farm Business Association. Raab is the state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

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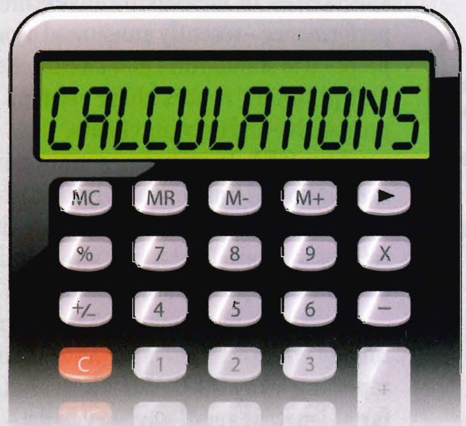
- Both crop insurance and disaster insurance payments *must* be treated the same way if received in the same taxable year.
- Crop insurance proceeds received in the year following harvest must be reported as income in the following year even if the producer normally sells the crop in the year that is harvested. (You can't report them in the year of damage if you don't receive them in that year).
- Be sure to enter the gross amount of proceeds and any offsetting entries in your recordkeeping. Often the crop insurance company will deduct unpaid premium from your proceeds. In this situation, producers often enter only the "net" check in their records. This discrepancy may not be discovered until the producer receives the 1099 form at year end. This error affects year-end tax planning if you are planning to defer the proceeds, because the gross amount must be deferred and any amount deducted for unpaid premiums are a current-year expense.
- Only crop insurance proceeds paid because of crop damage or the inability to plant crops are eligible for the deferral under Internal Revenue Code 451(d). Thus, crop insurance payments based on low county yield such as Group Risk Income Protection (GRIP) are not eligible for deferral. Also, payments made for a decline in the price of the commodity, rather than a physical loss, do not qualify for deferral. Insurance policies that have both a yield and price component such as Revenue Protection (RP) will require a separate calculation to determine the amount that can be deferred. See "RP insurance calculations."

If you had a crop insurance claim this year, be sure to consider the current tax provision and how it could impact your year-end tax planning. Because various insurance options and your specific details can affect your situation, we suggest you discuss deferring any crop insurance proceeds with your tax consultant to avoid any surprises. Your tax preparer will need to file an additional statement with your return to include details, such as the date and type of damage, insurance carrier's name and so on.

RP insurance



When the insurance payment is based both on the crop damage and the price loss, as in the case of Revenue Protection (RP) insurance, only the portion attributed to crop damage is eligible for deferral.

To calculate the deferral amount, you must calculate a percent of physical loss compared to the total loss. The formula for this calculation would be: physical loss/(physical loss + price loss). To help illustrate, below is an example.

FACTS:

(a) Approved Yield = 170 bu/acre

(b) Base Price = $6.50/bu

(c) Harvest Price = $7.50/bu

(d) Insurance Coverage = 75%

(e) Harvest Yield = 100 bu/acre

(f) Insurance Proceeds Per Acre = $206.25 (received in December)

DEFERRAL CALCULATIONS:

(g) Physical Loss Calculation = $525 per acre: 70 bu/acre (a-e) x $7.50(c)

(h) Price Loss Calculation = $0.00 per acre: zero since harvest price (c) exceeds base price (b)

(i) Deferral Formula Percentage = 1: 525 (g)/(525(g) + 0(g)

(j) Amount Eligible to Defer is $206.25: $206.25(f) x 1(i)

NOTE: Normally, if the harvest price *exceeds* the base price, the physical loss amount will constitute 100 percent of the total loss amount (all would be deferrable). However, if proceeds for the physical loss are received prior to the determination of the harvest price and the harvest price exceeds the base price, the additional payments could be attributed to price difference.

You may want to check more details regarding this example or find information regarding the legal aspect of a producer unable to fill forward grain contracts or tax rules for sale of livestock associated with the drought. See the "Tax and Legal Issues Associated With The 2012 Drought" article written by Roger McEowen, Center of Agricultural Law and Taxation, posted at http://tinyurl.com/CIdefer.