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Tax Planning for Crop and Crop Revenue Insurance

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Introduction:

With the wide variety of crop stress and moisture levels, many farmers may be collecting crop insurance prior to year end. The following is a short discussion of how to handle crop and revenue insurance indemnity payments from a tax standpoint. This discussion examines the topic as explained in the current Farmers Tax Guide. This topic MAY receive further clarification before the end of tax year 2007. Also listed are some additional crop insurance guidelines to keep in mind to insure compliance.

Indemnity Payment Deferral:

Any crop insurance proceeds you receive need to be included as income on your tax return. You generally include the income in the year received. Crop insurance payments include the crop disaster payments received from the federal government as the result of destruction or damage to crops. Payments also include compensation for the inability to plant crops because of drought, flood, or any other natural disaster as well as payment for loss due to those disasters.

You can postpone reporting crop insurance proceeds as income until the year following the year the damage occurred if you meet all the following conditions.

a. You use the cash method of accounting.
b. You receive the crop insurance proceeds in the same year the crops are damaged.
c. 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.

Generally, farmers are able to establish their practice of reporting crop income in a following taxable year by reference to their prior year's sale records.

In order for a payment to constitute insurance for the destruction of or damage to crops, the insured must suffer actual physical loss. Agreements with the insurance companies that provide for payments without regard to actual losses by the insured, such as payments in the event that county average yield is less than a specified amount, are not payments for the destruction of or damage to crops. Such payments do not qualify for deferral under I.R.C. 451(d). Also payments made for a decline in the price of the commodity, rather than a physical loss, do not qualify for deferral. This relates specifically to any revenue based crop insurance – CRC or RA with harvest price option.

Normally at year-end tax planning, decisions are made with respect to how crop insurance proceeds will be treated. The key point of this discussion is that insurance payments that are based upon total revenue or a combination of yield and price do NOT qualify for income deferral, even if the normal marketing cycle would place that income in the following tax year.

Conventional wisdom says that you should be able to take the portion of crop insurance received and defer ONLY the portion attributable to crop loss. This practice appears to be a very GRAY area with respect to current rules outlined in the Farmers Tax Guide. The primary purpose of this discussion is to raise awareness to this issue. If you have revenue insurance and will be collecting on the 2007 crop, be aware you may not be eligible to defer crop insurance proceeds as in past years.

Crop Insurance Guidelines:

If a crop loss is anticipated, especially for corn and soybean producers, make sure to verify production and which crop insurance unit the production came from. The crop insurance adjuster does not need to look at the field. For those who have revenue based crop insurance (CRC or RA-HPO) and optional units with the anticipation of a crop loss, they need to keep track of truck/wagon loads by field or mark the bin after each unit has been harvested. Combine monitor records can be used as an aid to break production out by field but is NOT documentation of actual bushels – bins still need to be measured. Check with your crop insurance agent.

If using a crop for other than what it was insured for (put to another use), contact your insurance agent before doing so. An example would be corn that was insured as grain but is now being chopped for silage. If there is a loss or a loss suspected, the insurance company must have an adjuster appraise the field. Serious penalties apply (no payment) if there is a loss and it is not appraised. If the adjuster can not appraise the field before harvest takes place, the producer needs to leave check strips. Check strips should be the width of the harvest machine or at least 4-6 rows every 20 acres. The check strips should be the length of the field. The exception here is if there is no loss expected which then triggers the 50% rule. That is, if the producer anticipates no loss of corn yield but wants to chop their worst field for silage, they can do so IF they are chopping less than 50% of the unit. If this is the case, they do not have to inform the insurance agent. The agent will simply prorate the harvested bushels to the acres that were chopped for silage. Again, if this is an issue, you may want to check with your insurance agent before harvesting.

If a yield loss occurs or is anticipated, contact your insurance agent as soon as possible. There are specific dates for notification in order to insure an indemnity payment if a loss occurs. For small grains the last day to turn in a loss is September 30. For a corn and soybean yield loss the last date is December 10. Revenue claims can be turned in up to 45 days after the fall harvest price is announced. This date varies depending upon which revenue product the producer has purchased – check with your insurance agent if you have questions. For additional information on this, go to www.cffm.umn.edu and look under "publications" and "farm management" for a document titled *Important Federal Crop Insurance Dates and Definitions.*

Due to drought conditions throughout most of the summer months, crops were severely stressed. This could result in reduced test weights. For corn and soybeans, additional quality factors kick in when test weights reach 49 pounds per bushel. If this occurs, there would be additional indemnity payments.

Crop insurance rules are technical and special conditions such as drought or flood can affect procedures. A very good rule of thumb is if you have questions, contact your insurance agent before destroying any crop or harvesting your crop.

References: 2002 National Income Tax Workbook
2005 and 2006 Internal Revenue Service Publication 225, Farmers Tax Guide