

Taxation of Crop Insurance and Disaster Payments

Weather variability is one of the largest sources of risk in agricultural production (see Figure 1). Congress has recognized the impact of weather variability on crop production and the resulting variability to farm income by implementing a special tax provision.



Figure 1. A weather event such as a drought can impact crop production, farm income and taxation situations.

Internal Revenue Code (IRC) Section 451(d) provides that, under certain circumstances, crop producers reporting on the cash method of accounting may elect to include crop insurance and disaster payments in income of the tax year following the taxable year of crop destruction or damage. To qualify for this election, the taxpayer must establish that the income from the destroyed or damaged crop would have been included in income for a taxable year following the year of destruction or damage under his or her normal business practices.

Additionally, crop disaster program payments received from the federal government qualify for the IRC Section 451(d) election if a natural disaster prevented a farmer from planting crops, or it destroyed or damaged crops that had already been planted.

Example

John Farmer operates a grain farm and uses the cash method of accounting. During 2020 John received the following amounts of insurance proceeds for the damage caused to his crops by a June 20th hailstorm: corn \$25,000, soybeans \$20,000 and wheat \$5,000.

If John can establish that under normal business practices he would have reported a substantial amount of the income from the 2020 crops in a subsequent tax year — he may report the insurance proceeds as 2020 income or he can elect to defer the \$50,000 of insurance proceeds to 2021.

Observation

- Substantial portion of the crop is considered to be more than 50 percent.
- To qualify for deferral, the insured must suffer an actual — not a contingent loss.
- Because the insurance proceeds in the example above are attributable to crops representing a single trade or business, John may elect to defer all or none of the insurance proceeds. He may not allocate the proceeds between the two years.
- Taxpayers receiving insurance proceeds in the tax year following the tax year of destruction or damage include the proceeds as income in the year of receipt without needing to make the IRC Section 451(d) election.
- Feed assistance and payments received under the Disaster Assistance Act of 1988 do not qualify for deferral under IRC Section 451(d).

Making the election

To qualify for the deferral, a taxpayer must make an affirmative election of eligible payments under IRC Section 451(d). The U.S. Internal Revenue Service (IRS) has denied deferrals when insufficient information was included with the return to qualify as an affirmative election and details relative to the deferral were missing. For example, the mere disclosure that insurance proceeds are being deferred does not constitute an election under IRC Section 451(d).

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To make the election, attach a statement with your name and address to the tax return for the year your crop was destroyed or damaged and crop insurance proceeds were received. The following information must be included on the attachment:

1. The taxpayer name and address.
2. A statement that the taxpayer is making an election under IRC Section 451(d).
3. Identification of crops destroyed or damaged.
4. Declaration that under normal business practices the income derived from the crops that were destroyed or damaged would have been included in gross income for a year following the taxable year of such destruction or damage.
5. Cause of destruction or damage of crops and the date(s) of such occurrence(s).
6. Total amount of payments received from insurance, itemized with respect to each specific crop and showing the date each payment was received.
7. Name(s) of insurance carrier(s) making the payments.

The election may be made on an amended return. However, once the election is made — it is binding for the taxable year for which it is made unless the commissioner consents to its revocation.

Revenue Protection (RP) policies

Payment is based on price, quantity and quality of the commodity produced. Only the payment for destruction or damage is eligible for the IRC Section 451(d) deferral. Therefore, a farmer who receives compensation from an

RP crop insurance policy must determine the portion of the indemnity payment due from crop destruction or damage rather than from reduced market prices when making an election to postpone recognition of income.

Missouri tax law

Senate Bill 641 (Section 143.121, No.3, Revised Statutes of Missouri [RSMO]) created an income tax subtraction for payments received from a program that compensates agricultural producers who have suffered a loss due to a disaster or emergency. The subtraction can be claimed on the Missouri Individual Income Tax Return (Form MO-1040), Missouri Fiduciary Income Tax Return (Form MO-1041) and the Missouri Corporation Income Tax Return (Form MO-1120) for tax years beginning on or after January 1, 2014.

Claims for the agricultural disaster relief for proceeds from crop insurance must include a statement of the loss or disaster (county, event).

Resources

The following are free references for further investigation into this topic.

[IRS Publication 225 Farmer's Tax Guide](https://www.irs.gov/publications/p225) (<https://www.irs.gov/publications/p225>). Note the printed version is available at most local MU Extension centers.

[IRS Publication 547 Casualties, Disasters and Thefts](https://www.irs.gov/publications/p547) (<https://www.irs.gov/publications/p547>).

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