TAX REPORTING OF CROP INSURANCE PAYMENTS
By Gary J. Hoff*

Synopsis: Many Illinois farmers will be receiving crop insurance payments because of low yields in 2005. This article discusses how these payments are reported for tax purposes.

Introduction

Congress recognized the unpredictability of the weather and its effect on farm income many years ago. Consequently, it developed crop insurance programs and special federal income tax provisions to help farmers survive financially in times of drought and flooding.

If weather conditions cause a crop loss, a farmer may be able to use net operating loss provisions in the Internal Revenue Code to recover taxes paid in prior years. If a farmer receives crop insurance proceeds for the crop loss, the farmer may have to report two years of normal income in one tax year. This “bunching” of income may qualify the farmer to use farm income averaging.

Taxation of Crop Insurance Payments

Qualifying farmers may elect to delay reporting crop insurance proceeds for a year. Internal Revenue Code Section 451(d) allows taxpayers who report their income and expenses on the cash method to report crop insurance and disaster proceeds in the year following the year of the loss. To qualify for deferral, crop insurance proceeds must result from damage to or the destruction of a farmer’s crops or weather-related inability to plant crops.

A taxpayer must show that it is his “normal practice” to hold crops until the following year before selling them.

The IRS does not specify how to determine if a farmer engages in the “normal practice” of deferring sales. However, the IRS determined in a 1973 letter ruling that a farmer who had deferred 57% of his crop sales in the preceding three years met the “normal practice” standard.

Example. Farmer Smith normally produces 40,000 bushels of corn each year. Smith’s standard practice is to store his corn for sale and deliver it in February of the following year. Because of the drought in 2005, Smith produced only 10,000 bushels and received a crop insurance check equal to the sale of 20,000 bushels. Since he received the check in 2005, the proceeds would normally be reported as 2005 income. However, because Smith’s “normal practice” is to sell his corn in the year following harvest, he can elect to report his crop insurance proceeds in 2006.

To elect to defer reporting the crop insurance proceeds, Smith must attach a statement to his tax return in the year of loss, which includes the following information:

1. A declaration that the taxpayer is making an election under IRC §451(d);
2. Identification of the specific crop or crops destroyed or damaged;
3. A declaration stating that, under the taxpayer’s normal business practice, income from the destroyed crops would have been included in gross income in the taxable year following the year of loss;
4. The cause of destruction or damage and the date the destruction or damage occurred;
5. The total amount of payments received from insurance carriers, itemized with
respect to each specific crop and the date each payment was received;

6. The name(s) of the insurance carrier(s) from whom payments were received.

The election covers all affected crops for the taxpayer’s trade or business. This means if the taxpayer receives proceeds for corn and soybeans, the election applies to all payments received. He cannot report a portion of the insurance proceeds in one year and the remainder in the next year. If the taxpayer farms as a sole proprietor and also farms in a partnership, he can make separate elections as they are considered separate businesses.

There are two categories of crop insurance policies and within these two categories are various types of policies. The categories are:

- Revenue policies, and
- Yield policies.

**Revenue policies** are based on the gross revenue a farmer receives for his crops. Therefore, a farmer’s average revenue might be down because of low crop prices, even though he had above average yields. Because these policies are not based on the loss of the farmer’s crop, they do not qualify for deferral.

**Yield policies** do qualify for deferral. In order to receive payment, a farmer must show that he suffered crop damage. A farmer can purchase a policy based on the percentage of his actual yield. Policies that base claims on a combination of yield and price probably do not qualify since they are not based entirely on crop losses.

Only individual policies that base claims on yield of the individual farmer purchasing the policy qualify for deferral. But, group policies are popular with some farmers. These policies base payments on the entire county’s average yield or revenue. A farmer may receive proceeds from this policy because the county had a loss, even though he did not suffer a loss on his farm.

The following table shows the types of crop insurance policies available and whether the proceeds are eligible for deferral.

Additional information on crop insurance deferral can be found in IRS Pub. 225, Farmer’s Tax Guide.

*Gary Hoff is an Extension Specialist in the Agricultural Law Group of the Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign. AGRICULTURAL LAW AND TAXATION BRIEFS are available at: www.farmdoc.uiuc.edu/legal/

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Name</th>
<th>Type</th>
<th>Qualify</th>
</tr>
</thead>
<tbody>
<tr>
<td>GRP</td>
<td>Group risk plan</td>
<td>County yield</td>
<td>No</td>
</tr>
<tr>
<td>CAT</td>
<td>Catastrophic insurance</td>
<td>Individual yield</td>
<td>Yes</td>
</tr>
<tr>
<td>APH</td>
<td>Actual production history</td>
<td>Individual yield</td>
<td>Yes</td>
</tr>
<tr>
<td>GRIP</td>
<td>Group risk income plan</td>
<td>County revenue</td>
<td>No</td>
</tr>
<tr>
<td>IP</td>
<td>Income protection</td>
<td>Individual revenue</td>
<td>No</td>
</tr>
<tr>
<td>RA</td>
<td>Revenue assurance</td>
<td>Individual revenue</td>
<td>No</td>
</tr>
<tr>
<td>CRC</td>
<td>Crop revenue coverage</td>
<td>Individual revenue</td>
<td>No</td>
</tr>
</tbody>
</table>