



UNIVERSITY OF MINNESOTA  
**EXTENSION**

# Ag Business Management

*Informing farm families and ag businesses about management issues.*

## Tax Planning for Crop and Crop Revenue Insurance

Prepared by

C. Robert Holcomb, Extension Educator, University of Minnesota Extension

Gary A. Hachfeld, Extension Educator, University of Minnesota Extension

June 2009

### Introduction:

With the probability of crop losses due to weather, farmers may be receiving crop insurance indemnity payments. 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 of indemnity payment and disaster payment deferral from a tax planning viewpoint.

### Disaster Payments and Crop Insurance Indemnity Payments:

Any crop insurance proceeds you receive need to be included as income on your tax return. You generally include that income in the year received. Crop insurance includes the crop disaster payments received from the federal government as the result of destruction or damage to crops, or the inability to plant crops, because of drought, flood, or any other natural disaster.

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 (GRP, GRIP), 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 (revenue loss), rather than a physical loss, do not qualify for deferral.

The revenue based indemnity payments farmers receive are based on price as well as quantity and quality of the commodity produced. **Only the payment for destruction or damage (yield loss) is eligible for deferral.** A farmer who receives compensation from a CRC policy for example, must determine the portion of the payment that is due to crop destruction or damage rather than due to a reduced market price (revenue loss).

A revenue based policy guarantees a minimum amount of revenue per acre for the insured farmer. The policy provides a formula for computing the deemed revenue the insured received from the crop that was produced. Taken into account is price of the commodity at the time of harvest, the quantity the insured farmer harvested and the quality of the commodity harvested.

This deemed revenue is compared with the guaranteed minimum revenue. The excess of the guaranteed minimum over the deemed revenue received is the amount paid to the insured farmer.

The insured farmer's deemed revenue (**calculated revenue**) is computed by multiplying two factors:

1) **Production to Count**: this equals the harvested and appraised production and includes a quality adjustment.

2) **Harvest Price**: is based on an appropriate futures contract price for the crop as defined in the insurance policy.

The guaranteed minimum amount of revenue (**final guarantee**) is computed by multiplying three factors:

1) **Approved Yield Per Acre**: is the historical average amount of production/acre of land covered by the policy.

2) **The greater of**:

a) **Base Price**: is based upon an appropriate futures contract price for a period before the crop was planted as defined in the policy.

b) **Harvest Price**: as defined earlier.

3) **Coverage Level Percentage**: is the level of coverage the insured farmer chose when he or she purchased the policy.

It is reasonable to allocate the payment by separately calculating the revenue loss due to destruction and damage and the revenue loss due to a reduced market price. The insurance proceeds can then be multiplied by the ratio of the revenue loss due to destruction to the total revenue loss.

**Example – CORN (harvest price less than base price):**

- Acres insured - - 1 acre
- Approved yield (APH) - - 140 bushels
- Base price - - \$4.06
- Harvest price - - \$3.58
- Coverage level - - 65% CRC
- Production to count - - 50 bushels

**Calculation: CRC Payment**

**Final Guarantee:**

Approved yield – bu./ac.	140	
Greater of base/harvest price	x \$4.06	
Coverage level	x <u>0.65</u>	
Final Guarantee (a)		\$369.46

**Calculated Revenue:**

Production to count – bu./ac.	50	
Harvest price	x <u>\$3.58</u>	
Calculated Revenue (b)		\$179.00

**Insurance Proceeds: (a-b)**

**\$190.46**

**Yield loss:**

Approved yield – bu./ac.	140	
Production to count – bu./ac.	- <u>50</u>	
Damage loss – bu./ac.	90	
Harvest price	x <u>\$3.58</u>	
Revenue loss from damage: (c)		\$322.20

**Price loss:**

Greater of base/harvest price	\$4.06	
Harvest price	- <u>\$3.58</u>	
Price loss	\$ .48	
Production to count bu./ac.	x 50	
Revenue loss from reduced price: (d)		<u>\$ 24.00</u>

**Total Revenue Loss: (c+d)**

**\$346.20**

**Amount Eligible for Deferral:**

**Physical Loss:**  $\$322.20 \div \$346.20 = 93.07\%$

Amount Eligible for Deferral:

$$.9307 \times \$190.46 = \underline{\underline{\$177.26 \text{ per acre}}}$$

The remaining \$13.20 (**revenue loss**) is not eligible for possible deferral.

If the harvest price equals or exceeds the base price, the formula used in the previous example (harvest price less than base price) would end up allocating all of the CRC proceeds to destruction and damage or yield loss, making it eligible for deferral.

NOTE: This is a complicated issue and varies from one producer to another. See your tax preparer for additional information specific to your situation.

## **Publication References:**

National Income Tax Workbook 2008

Land Grant University Tax Education Foundation, Inc.

College Station, TX [www.taxworkbook.com](http://www.taxworkbook.com)

2008 Farmers Tax Guide (Publication 225) [www.irs.gov](http://www.irs.gov)

Income Tax Management for Farmers in 2008

CES Paper No. 364-W, November 2008

George F. Patrick, Department of Agricultural Economics, Purdue University

*The University of Minnesota is committed to the policy that all persons shall have equal access to its programs, facilities, and employment without regard to race, color, creed, religion, national origin, sex, age, marital status, disability, public assistance status, veteran status, or sexual preference.*