

Income Tax Options in a Drought Year

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When weather conditions are sufficiently adverse to cause crop or livestock losses or cause sale of livestock prematurely, then some special tax rules may be useful.

Crop Insurance and Disaster Payments

For farmers using cash method accounting, crop insurance or disaster payments may be reported in the year received or may be postponed one year under qualifying circumstances. If a farmer normally receives the payment for a crop in the next tax year, then an 'election' can be made to postpone the crop insurance or disaster payments to that next year. The election can be made with a detailed statement attached to the tax return in the year the payment is received. Appropriate amounts are entered in Line 8 of Schedule F (Form 1040). See Schedule F instructions.

If crop insurance and/or disaster payments are received for more than one crop, then the amounts must be added together and either all reported in the year received or all postponed. This is only for the insurance and disaster payments, regular crop sales for cash method farmers are counted as income in the year received. We also need to note that there is a difference between crop insurance due to lower yield and crop revenue coverage that may be from lower yield or lower market prices.

If crop revenue coverage results in a payment, then the portion of the payment due to destruction or damage (lower yield) may be eligible for deferral. The portion due to lower market prices is not eligible for deferral. The payment would need to be prorated between lost revenue due to reduced yield and lost revenue due to reduced price.

Livestock

The gain may be postponed one year for livestock sold in excess of normal business operations if it's due to a weather-related lack of feed or water. The weather-related condition must have caused the sale and resulted in an area declared eligible for federal assistance. The livestock are not required to be located or raised in a county declared eligible, but the weather must have caused an area to be eligible and that weather caused the excess sale of animals.

For dairy, draft or breeding livestock sold in excess of normal practices, gain may be deferred if replacement livestock are purchased within two years of the end of the tax year of the excess sale. This may become four years or more under some conditions. Elections for postponement of gain on livestock sold or replacement of livestock with an accompanying deferral of taxes on gain should normally be made by the due date of the return (including extensions). Under some situations the election can be made later.

These are general rules for income tax options in a drought year that allow postponement of paying taxes on income. Each farmer's situation may have unique circumstances, so consult appropriate publications or your tax preparer before making these elections.