



Lesson 6.6: Special Tax Rules for Agriculture - Catastrophe and Disasters



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1

This training provides greater detail on provisions of the tax code that relate to loss of farm or ranch property.



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This presentation is intended to provide general information on agricultural income tax issues and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State laws vary and no attempt is made to discuss state specific laws. For advice about how these issues might apply to your individual situation, consult an attorney.



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3

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4

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Program Overview

1. Filing: Federal Income Tax Filing Requirements
2. Records: Recordkeeping Requirements
3. Taxes: Individual Federal Income Tax Return
4. Entities: Business Entities and Federal Tax
5. Agricultural Income: Special Rules
- 6. Special Tax Rules for Agriculture** <- We are here.



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5

There were five lessons previously in this series.

The ing covers special tax rules for agriculture.

Lesson 6

Overview - Special Tax Rules for Agriculture



- 6.1 USDA Payments
- 6.2 Debt Relief
- 6.3 Mixed Use Real Property
- 6.4 Value-Added Inventory
- 6.5 Conservation
- 6.6 Catastrophe and Disasters** <- We are here.
- 6.6.a Livestock Losses and Weather-Related Sales



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6

Types of Losses - Causes


This lesson is about the tax treatment of loss of business property and related compensation (from insurance or government programs) due to:

- Theft
- Casualty
- Casualty losses caused by a Federally Declared Disaster

Note that different rules apply for the loss of non-business property such as a personal residence and its furnishings.



The rules for calculating a loss are the same for theft and casualty.

You  need to prove the property was stolen; you do need to show that it is no longer available for use in your business.

Casualty means anything sudden and unexpected that causes the property to become unusable or significantly less functional. A gradual decrease in functionality is not a casualty. Common causes of casualty losses include:

Fire
Flood
Hurricane, tornado, volcano, earthquake
Unexpected outbreak of disease
Theft
Vandalism

Special rules apply when casualty losses occur as a result of a federally declared disaster.

Types of Losses - Property Types - Crops and Livestock Held for Sale

- Most farm/ranch tax returns already deduct all costs associated with producing crops or livestock held for sale.
- Generally, there is no additional deduction associated with this type of loss because all of the costs have already been deducted.
- But, there are some special tax rules to help farmers who have had these types of losses.
- See also Lesson 6.6.a for additional rules for livestock.



Most farms and ranches earning less than \$25 million a year report taxable income and expenses without accounting for inventories of crops or livestock.



When the crop or livestock is lost, the farmer or rancher does not have additional costs associated with the crop or livestock, they just have less opportunity to earn revenue.

This means that most of the costs associated with growing a crop or raising livestock are deducted in the year the cost is incurred, with a possible allowance for Non-Incidental Materials and Supplies Inventory as discussed in Lessons 2 and 6.2.

Types of Losses - Property Types - Crops and Livestock Held for Sale

Payments for lost crops or livestock:

- Crop insurance
- Non-insured Crop Disaster Assistance (NAP)
- Other government payments
- Other private income insurance (business interruption insurance)

All of these types of income are taxable, unless Congress has specifically said that a certain type of program payment is not taxable.



Crop insurance is a type of insurance intended to replace lost earnings when crops or livestock cannot be sold due to an event covered by the insurance.



Most crop insurance is purchased from private insurance companies who offer insurance through a partnership with the USDA Risk Management Agency. This is known as "Federal Crop Insurance." Federal Crop Insurance is available for hundreds of different crops grown in hundreds of different locations.

"Private crop insurance" is available coverage on limited crops, usually just for damage due to rain and hail.

In addition, for crops which cannot be covered by federal or private crop insurance, the USDA Farm Service Agency offers a Noninsured Disaster Assistance Program known as "NAP."

The USDA may offer occasional programs to compensate farmers and ranchers for lost revenue following a federally declared disaster.

Some businesses have private "business interruption insurance" to compensate for

lost revenue related to an insurable cause of loss.

Types of Losses - Property Types - Crops and Livestock Held for Sale

- Payments for lost income are generally taxable.
- A taxpayer may elect not to be taxed on crop insurance or disaster relief payments in the year received, and instead defer the payment to the following year.



All of these types of income are taxable, unless Congress has specifically said that a certain type of program payment is not taxable.



Report proceeds from federal crop insurance, NAP, and other federal disaster assistance on line 6 of Schedule F.

Types of Losses - Property Types - Business Property

Business property is the assets used in the business including:

- Land improvements including roads, irrigation ponds, planted windbreaks, etc.
- Buildings, fences, wells, irrigation systems, etc.
- Tractors, trailers, implements, small tools, etc.
- Trees, vines and bushes that produce annual crops
- Livestock not typically held for sale, but used in the business including:
 - Roping horses, working dogs
 - Breeding livestock
 - Dairy animals
 - Laying hens
 - Animals held primarily to produce fiber



These types of assets may be protected with private property insurance. If destroyed, you will receive a payment related to the loss of value or the replacement cost of the asset.



Types of Losses - Property Types - Business Property

There are a few USDA programs specifically for loss of business property including:

- The Tree Assistance Program
- The Livestock Indemnity Program



Tax issues for casualty loss of business property

There are two aspects to taxation for casualty losses of business property:

1. The treatment of the depreciable asset
2. The treatment of any proceeds received from insurance or salvage sale



The Asset

You will have taxable gain or loss equal to the difference between insurance or salvage sales proceeds and the tax basis of the asset.

To find the tax basis:

1. Identify the asset on the asset list
2. Identify the original cost of the asset
3. Identify the total amount of tax depreciation deductions taken to date - this is called "accumulated depreciation"
4. The difference between 2 and 3 is the "tax basis" of the asset.

Note that the tax basis of an asset is different if the asset was received as a gift or inheritance. See Lesson 2 and Pub 225.



For tax purposes, you will have a gain or a loss related to the lost use of the asset.

If you are prepared by a tax preparer or computerized tax preparation software, you should have a list of all tax assets and the amount of depreciation taken to date.

If you do not have this list, you may need to recreate it.

If you have not properly reported assets and depreciation in the past you may need to amend prior years' returns. See Lesson 2.

If you do not have records to show that you have tax basis in an asset, you should assume your tax basis in the asset is zero.

Tax Loss from Asset Loss

- Tax losses may be claimed in the year experienced.
- Tax losses associated with a federally declared disaster may be claimed in the year PRIOR to the actual loss by amending the prior year return.
- This allows the taxpayer to quickly receive a refund of prior year taxes instead of waiting to report the loss when the tax return is due.



If a casualty loss occurs in February the loss would generally be reported on a tax return filed in April of the Following year.



Allowing taxpayers to take a loss in the prior tax year means a farmer with a loss in February could potentially claim the loss on a timely filed return for the year prior to the loss and have the benefit of the loss within a few weeks.

If the prior year tax return has already been filed, the taxpayer would need to amend the prior year return to claim a refund. This still gets the value of the refund to the taxpayer far more quickly than waiting to file the tax return for the year in which the loss occurred.

Tax Loss from Asset Loss

Example:

Purchase Price: \$2,000
Less: Accumulated Depreciation \$1,500
Equals: Tax Basis: \$500

Insurance Proceeds: \$250
Plus: Salvage Sale Proceeds: \$50
Equals: Total Proceeds: \$300

Total Proceeds: \$300
Less: Tax Basis \$500
Equals: Capital Loss (\$-200)



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16

Review from Lessons 1 and 2:

Tax basis is the cost to buy or create the asset minus the total of all depreciation deductions taken.

Livestock you bred and raised may have zero basis because you deducted all of the costs associated with the animal as you incurred them.

For additional special rules for livestock sales due to weather-related events see Lesson 6.6.a.

Tax Gain from Asset Loss

Example:

Purchase Price: \$2,000
Less: Accumulated Depreciation \$2,000
Equals: Tax Basis: \$0

Insurance Proceeds: \$250
Plus: Salvage Sale Proceeds: \$50
Equals: Total Proceeds: \$300

Total Proceeds: \$300
Less: Tax Basis \$0
Equals: Capital Gain \$300



If you are given an asset, your tax basis in the asset is the same as the tax basis of the person who gave it to you. Unless you can show a tax basis greater than zero, an asset as a gift probably has a tax basis of zero.

If you receive an asset as an inheritance, your tax basis is the fair market value of the asset on the date of death of the person from whom you inherited. Alternatively, you can elect to use the fair market value of the asset six months after the date of death.

Typically, you will need a written appraisal, or other written evidence such as examples of similar items available for sale to establish your basis in an inherited item.

Tax Gain from Asset Loss and IRC Section 1033

Gain is insurance or sales proceeds in excess of tax basis.

Gain is taxable income.

If the proceeds are used to replace lost property, the gain may be deferred to a future year.

Defer gain by reducing the basis of the new property by the amount of gain. This will:

- 1. Reduce the depreciation deduction for the new property
- 2. Increase the gain on the sale of the new property
- Additional considerations include:
 - Deadlines for acquiring new property
 - Allowable types of new property
- Seek additional information regarding **IRC 1033** and the assistance of a qualified tax preparer.



If you have a tax gain from an asset loss, you may delay recognizing the gain as taxable income if you use the proceeds to restore or replace the original property.



Seek additional information regarding **IRC 1033** and the assistance of a qualified tax preparer.

If you use the proceeds to replace the property you lost, you may avoid being taxed on the gain in the year of the sale by adjusting the basis of the new property to account for the gain from the old property.

You will not be able to deduct the full replacement cost through depreciation.

If you sell the asset, you will recognize the postponed gain at the time of the sale.

There are a number of additional considerations regarding when you acquire the new property and what type of new property qualifies.

The purpose of this lesson is to make you aware of this option.

You will need additional information regarding IRC 1033 and the assistance of a

qualified tax preparer in order to make the election.

Clean up and recovery

- Clean up and recovery costs are generally deducted as ordinary and necessary business expenses.
- To the extent that clean up and recovery involves repairing or replacing assets, costs must be capitalized and later deducted through depreciation.



Questions?

Thank you!



How do I learn more about federal income taxes and my farm or ranch?

- There are previous lessons in this series.
- For each lesson there is a short set of questions you can answer to help you decide if the training will be useful to you.
- You can access the questions and the trainings here:
- <https://law.uark.edu/academics/llm-food-ag/llm-projects-agftap.php>
- Additional project resources are available here: <https://agftap.org>



How do I learn more about federal income taxes and my farm or ranch?

IRS Publication 225, The Farmers Tax Guide

RuralTax.org

IRS website and publications



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22





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