



Current Report

Division of Agricultural Sciences and Natural Resources • Oklahoma State University

Disaster and Casualty Losses

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Oklahoma has experienced extreme weather and natural disasters in the last few years. Fire, flood, tornado, hail, and drought have all occurred in 1995 and 1996. Some areas have been declared a disaster area by the President, other areas have been declared eligible for federal assistance by the Secretary of Agriculture. The county Farm Service Agency or county Oklahoma Cooperative Extension Service offices have additional information about which counties are eligible.

The income tax code provides partial relief in the form of tax benefits that are available to taxpayers who have experienced a casualty loss in an area declared to be a disaster by the President of the United States. Taxpayers can take advantage of these benefits by filing certain elections with their income tax returns. These elections and the tax treatment of disaster payments and crop insurance proceeds will be discussed and illustrated. Also, the special tax elections for livestock sold because of drought conditions are explained in Current Report 788, available through each county Oklahoma Cooperative Extension Service office.

If you have experienced a disaster, casualty loss, or drought related livestock sale, take this current report to your tax preparer. This information will help ensure you get the maximum legal tax benefits.

Presidential Disaster Areas

If a taxpayer has a casualty loss in an area that is declared by the President to be eligible for federal assistance under the Disaster Relief and Emergency Assistance Act, that loss can be deducted in the current year or the tax year previous to the loss. The election to file an amended return allows deduction of the loss on the prior year tax return. This election could provide more immediate financial relief through a refund of the prior year tax. However, taxpayers can choose to report the loss in the year in which it occurred.

Disaster Payments and Crop Insurance

For cash method farmers, there is an exception to the general rule that payments must be reported in the year they

are received. This exception allows farmers to postpone reporting a payment by one year. It does not allow the taxpayer to accelerate reporting the payment if the payment is received the year after a loss.

Generally, these rules apply when crops cannot be planted or are damaged or destroyed by natural disaster such as a drought or a flood. The exception applies to crop insurance proceeds; disaster payments received from the Federal government under the Agricultural Act of 1949, as amended; and disaster payments received under the Disaster Assistance Act of 1988. Under the regulatory language, the provision applies to all federal payments received after December 31, 1973, for losses due to a natural disaster.

Qualifying for the Election

To qualify for the exception, a taxpayer must be able to show that, under the taxpayer's normal business practice, the income from the crop for which the payment is received would have been reported in a year following the receipt of the payment.

Two Options for Reporting on Tax Returns

Taxpayers who qualify for this exception have the option of reporting the payment as income in the year it is received or as income in the following year.

- The election to postpone reporting the payment as income covers all crops from a farm.
- A separate election must be made for each farming business of a taxpayer.
- For purposes of this provision, separate businesses are defined as those for which the taxpayer keeps separate books and is allowed to use different methods of accounting.
- In general, that requires the businesses to be separate and distinct.

How to Make the Election

The election must be attached to the return (or amended return) for the tax year in which the payment was received. The statement must include:

1. The name, address, and social security number of the taxpayer.
2. A declaration that the taxpayer is making an election under IRS Code Section 451(d).
3. Identification of the specific crop or crops destroyed or damaged.
4. A declaration that under the taxpayer's normal business practice the income derived from the crops that were destroyed or damaged would have been included in his gross income for a taxable year following the taxable year of such destruction or damage.
5. The cause of destruction or damage of crops and the date or dates on which such destruction or damage occurred.
6. The total amount of payments received from insurance carriers, itemized with respect to each specific crop and with respect to the date each payment was received.
7. The name(s) of the insurance carrier or carriers from whom payments were received.

Example 1

A taxpayer normally sells her soybean and cotton crops in the year after they are produced. In 1995, her soybean and cotton crops were damaged by flooding. She had insurance to cover the loss and received a payment from the insurance

company of \$15,000 for soybeans and \$21,000 for cotton in November 1995. How is this transaction reported?

Answer 1

She can postpone reporting the \$36,000 of income by attaching the following statement to her 1995 return (Figure 1). She then reports the \$36,000 on line 8a of her 1995 Schedule F and excludes it from taxable income by not reporting it on line 8b. She cannot postpone reporting the payment for one crop unless she postpones reporting the payment for both.

Example 2

In 1995, a taxpayer received \$8,000 of crop insurance proceeds due to hail damage on his wheat crop, and also received \$14,000 of disaster payments as a result of drought damage to his milo crop. Can he elect to include in income the crop insurance proceeds for his wheat and defer the disaster payment for his milo, since one payment is crop insurance and the other payment is a disaster payment?

Answer 2

No, both crop insurance proceeds and disaster payments must be aggregated in determining whether to defer the income reporting or to include the payment in current year income. Crop disaster payments are specifically identified as equivalent to crop insurance proceeds and thus both types of payments are to be reported in a consistent manner. Therefore, he must decide between reporting the entire amount of payments (\$8,000 + \$14,000) in 1995 or deferring both payments to 1996, assuming he meets the requirement of

Figure 1. Election Under IRS Code Section 451(d) to Postpone Recognition of Crop Insurance Proceeds

Taxpayer 000-00-0001
Route 2, Box 169
Yourtown, OK 74000

The above taxpayer hereby elects to postpone the recognition of the following crop insurance proceeds. The income from the crops for which these proceeds were received would have been included in gross income in a year following the year of distribution or damage under the taxpayer's normal business practice.

<i>Crop destroyed or damaged</i>	<i>Cause</i>	<i>Date of Damage</i>	<i>Payment Received</i>	<i>Date of Payment</i>	<i>Insurance Carrier</i>
Soybeans	Flood	6/10/95	\$15,000	10/15/95	Crops Ins., Inc.
Cotton	Flood	6/10/95	\$21,000	10/15/95	Crops Ins., Inc.

Observation: Some farmers have deferred crop insurance and disaster payments from 1995 to be reported in 1996. Those payments should be reported on line 8d of the 1996 Schedule F.

normally selling more than 50 percent of those crops in the following year.

Example 3

Assume that the taxpayer in Example 2 had received the \$8,000 of crop insurance proceeds for the wheat loss in his sole proprietorship grain farm, and had received the \$14,000 of disaster payments for drought damage to milo grown by a farming partnership in which he is a 50 percent partner. The sole proprietorship wheat farm and the partnership milo farm are separate farming businesses and keep separate records. Can this taxpayer elect to include in income the \$8,000 of crop insurance proceeds for his wheat, while the partnership farm elects to defer the disaster payment received for milo?

Answer 3

Yes, the two separate farming operations in which he participates do not have to make the same election. If a taxpayer has more than one farming business, he makes a separate election for each such business. Separate farming businesses are those for which the taxpayer keeps separate books and is allowed to use different methods of accounting.

Useful Information for Your Tax Preparer

Notice 89-55, 1989-20 IRB 134, May 15, 1989, explains the application of IRS Code Section 451(d) for many situations but leaves one ambiguity: the treatment of disaster payments and crop insurance payments when they are received for two different crops and the crops are normally marketed in different years by the producer.

1. In Rev. Rul. 74-145, 1974-1 C.B. 113, the IRS stated that if a producer normally sold 50 percent of all crops in the

year following the year of harvest, then all insurance payments would be postponed until the following year if the Sec. IRS Code Section 451(d) election were made.

2. Notice 89-55 and IRS Code Section 451(d) says that insurance proceeds and disaster payments can be postponed, "if the taxpayer establishes that, under its normal business practice, income from the crops would have been reported in the year following the year of destruction or damage." That language can be interpreted as saying that insurance and disaster payments received for crops that are normally marketed in the year of harvest cannot be postponed even if the election is made.

Example 4

Assume the facts are the same as Example 1, except that the first taxpayer normally sells her soybeans at harvest time. How are the insurance payments reported?

Answer 4

Rev. Rul. 74-145 seems to say that the insurance payments received for the cotton and soybeans must be treated the same and would be eligible for the IRS Code Section 451(d) election if the sales from both crops that are normally postponed are more than 50 percent of the total.

Possible argument: It could be argued that the language of IRS Code Section 451(d) does not allow her to postpone reporting the payment received on her soybeans since she normally sells that crop in the year it is harvested. Notice 89-55 does not clarify this issue since it uses the language of the Code but does not specifically overrule Rev. Rul. 74-145.

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The Cooperative Extension Service is the largest, most successful informal educational organization in the world. It is a nationwide system funded and guided by a partnership of federal, state and local governments that delivers information to help people help themselves through the land-grant university system.

Extension carries out programs in the broad categories of agriculture, natural resources and environment; home economics; 4-H and other youth; and community resource development. Extension staff members live and work among the people they serve to help stimulate and educate Americans to plan ahead and cope with their problems.

Some characteristics of the Cooperative Extension system are:

- The federal, state and local governments cooperatively share in its financial support and program direction.
- It is administered by the land-grant university as designated by the state legislature through an Extension director.
- Extension programs are nonpolitical, objective and based on factual information.
- It provides practical, problem-oriented education for people of all ages. It is designated to take the knowledge of the university to those persons who do not or cannot participate in the formal classroom instruction of the university.
- It utilizes research from university, government and other sources to help people make their own decisions.
- More than a million volunteers help multiply the impact of the Extension professional staff.
- It dispenses no funds to the public.
- It is not a regulatory agency, but it does inform people of regulations and of their options in meeting them.
- Local programs are developed and carried out in full recognition of national problems and goals.
- The Extension staff educates people through personal contacts, meetings, demonstrations and the mass media.
- Extension has the built-in flexibility to adjust its programs and subject matter to meet new needs. Activities shift from year to year as citizen groups and Extension workers close to the problems advise changes.

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