

2024 Crop Insurance Income Tax Decisions and Strategies

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often.

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Agenda

- Crop Insurance Reporting Requirements and Deferral of Income
- Revenue Protection vs. Damage and Destruction
- Requirements of the Election
- Tax Planning Techniques



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Crop Insurance and Disaster Payments

- Included in Schedule F income
- Timing of payment may double up income for the cash basis taxpayer
- I.R.C. §451(f) allows 1-year deferral
- No provision to accelerate income from a “late” payment
- Election applies to both crop insurance and disaster payments for that year
- No deferral of revenue protection insurance payments

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Revenue protection insurance

- Very common to have one policy that covers both disaster losses and revenue losses
- Allocation needed for potential deferral amount



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Example 1: No Revenue Loss

Example 1			
Revenue Protection Policy Proceeds			
Harvest Price Higher Than Base			
Approved Yield	180 Bushels per acre		
Coverage Level	85%		
Base Price	\$	4.66	
Harvest Price	\$	4.86	
Actual Yield	75 Bushels per acre		
Guaranteed amount	180 bushels x \$4.66 base price x 85% coverage level	\$	213,894.00
	x 300 acres		
Calculated Revenue	75 bushels x \$4.86 harvest price x 300 acres	\$	(109,350.00)
Insurance Payment		\$	104,544.00

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Example 1 (Cont.)

The difference between the approved yield and the actual yield was 105 (180 - 75) bushels. The yield loss from destruction or damage was \$153,090 (105 bushels × \$4.86 harvest price × 300 acres). There was no price loss because the \$4.86 harvest price exceeds the \$4.66 base price. The \$104,544 paid by the insurance company is all eligible for deferral because it is fully related to the damage loss.

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Example 2: Prorate Insurance Yield Loss vs. Revenue Loss

Example 2			
Revenue Protection Policy Proceeds			
Harvest Price Lower than Base			
Approved Yield	180 Bushes per acre		
Coverage Level	85%		
Base Price	\$	4.66	
Harvest Price	\$	4.16	
Actual Yield	75 bushels per acre		
Guaranteed amount	180 bushels x \$4.66 base price x 85% coverage level		
	x 300 acres		\$ 213,894.00
Calculated Revenue	75 bushels x \$4.16 harvest price x 300 acres		\$ (93,600.00)
Insurance Payment			\$ 120,294.00

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Example 2 (Cont.)

The difference between the approved yield and the actual yield was 105 (180 - 75) bushels. The yield loss from destruction or damage was \$131,040 (105 bushels × \$4.16 × 300 acres), and the price loss from market decline was \$11,250 [(\$4.66 - \$4.16) × 75 bushels × 300 acres]. The total revenue loss is \$142,290 (\$131,040 + \$11,250). The loss from the destruction of the crop is 92.09% (\$131,040 ÷ \$142,290) of the total revenue loss. Farmer can defer \$110,779 (\$120,294 insurance payment × 92.09%).

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Making the deferral election

- Payment must be received in the year of damage
- Must show normal business practice is to sell crop the following year
- Records support more than 50% of crop normally carried over
- Eighth Circuit case held that each covered crop must meet the test
- Elsewhere, reasonable to combine all covered crops



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Making the deferral election

- Election applies to all payments on all covered crops of that trade or business
- Election requires statement of details by crop
- Sch. F line 6 is completed accordingly
- Sch. F, line 6d is completed the following year with deferred income

6 Crop insurance proceeds and federal crop disaster payments (see instructions):			
a	Amount received in 2020	6a	6b Taxable amount
c	If election to defer to 2021 is attached, check here <input type="checkbox"/>	6d	Amount deferred from 2019
			6d

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Election Statement

1. Name and address of the taxpayer (or a duly authorized representative)
2. A statement that the farmer is making an election under section 451(f) [the regulation references section 451(d), which was changed by the TCJA] and Treas. Reg. § 1.451-6
3. Identification of the specific crop or crops physically destroyed or damaged
4. A statement that under normal business practice the farmer would have included income from the destroyed or damaged crops in gross income for a tax year following the year the crops were destroyed or damaged
5. The cause of the destruction or damage of the crops and the date or dates it occurred
6. The total payments received from insurance carriers, itemized for each specific crop, and the date each payment was received
7. The name of each insurance carrier from whom payments were received

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Election filed with Return

Election under I.R.C. § 451(f) to Postpone Recognition of Disaster Payments and Crop Insurance Proceeds Jennifer Garcia, SSN XXX-XX-XXXX Route 2, Box 2 Bitterweed, MS 38000					
Jennifer Garcia elects to postpone recognition of the following disaster payments and crop insurance proceeds under I.R.C. § 451(f) and Treas. Reg. § 1.451-6. The crops for which these proceeds were received would have been sold in 2022 under her normal business practice.					
Crop Destroyed or Damaged	Cause	Date of Destruction or Damage	Payment Received	Date of Payment	Insurance Carrier or Other Payer
Soybeans	Rain	05/10/2021	\$15,000	10/15/2021	Crops Ins., Inc.
Corn	Drought	07/10/2021	\$21,000	10/15/2021	Crops Ins., Inc.

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A few words on records.....

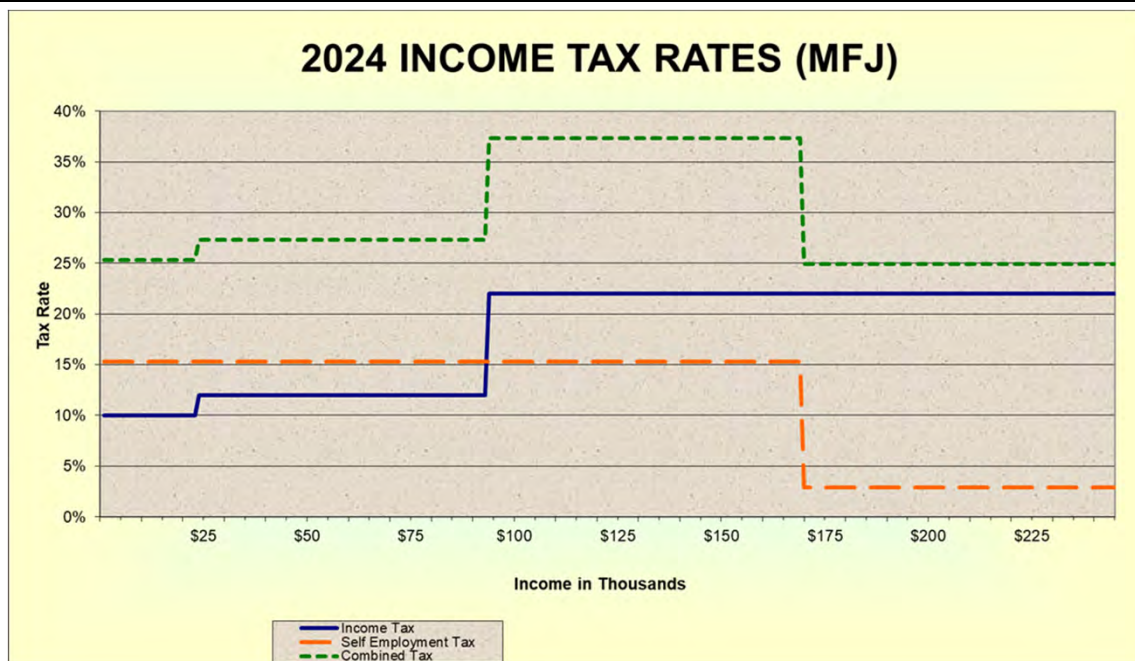
- Least favorite task of all farmers
- Also, the most necessary
- Either computer software or manual record book works
- The main thing is to have a system
- Reconcile...Reconcile...Reconcile
- System should include a section for
 - Farm income, expense, capital purchases, capital sales, and personal income and expenses



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2024 INCOME TAX RATES (MFJ)



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Tax Due at Various Income Levels (2024)

Taxable Income	Federal Tax	Self-Employment Tax (SE)	Fed and SE Tax Combined	State (MN) Tax	Total of Federal and State
\$ 50,000	\$ 1,383	\$ 7,065	\$ 8,448	\$ 956	\$ 9,404
\$ 75,000	\$ 3,427	\$ 10,598	\$ 14,025	\$ 2,233	\$ 16,258
\$ 100,000	\$ 5,653	\$ 14,129	\$ 19,782	\$ 3,772	\$ 23,554
\$ 150,000	\$ 10,117	\$ 21,194	\$ 31,311	\$ 7,029	\$ 38,340
\$ 250,000	\$ 26,538	\$ 27,601	\$ 54,139	\$ 14,064	\$ 68,203
\$ 500,000	\$ 97,281	\$ 34,297	\$ 133,484	\$ 38,780	\$ 172,264
** Calculations based upon MFJ status					
*** Calculations include Qualified Business Income (QBI) Deduction for all income					

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Tax Planning Strategies

- Pre-Pay Expenses
- Income Averaging
- Deferral of Income
 - Crop and/or Livestock sales
- Accelerated Depreciation
 - Section 179 and Bonus
- Crop Insurance Deferral



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Prepaying expenses

- Cash basis deduction generally limited if useful life beyond end of tax year
- 12-month rule provides an exception if benefits do not extend beyond the ***earlier of***
 - 12 months after the benefit begins, or
 - the end of the following tax year
- Example: One-year insurance premium paid in November is okay
- Planning Note - No prepaid interest, only to year-end

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Prepaid farm supplies exception and limit

- Prepaid farm supplies may still be limited to 50% of all other expenses
 - Unused due to fire, storm, flood, etc. is not counted
- Limit doesn't apply to taxpayer who
 - Is a *farm-related taxpayer* and
 - Has total prepaid farm supplies for the preceding 3 years of less than 50% of all other expenses or
 - Exceeds limit due to unusual change in business operations

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Prepaid farm supplies

3-part test for prepaid expense deduction

1. Payment, not deposit

- Facts and circumstances
- Constructive Receipt
 - Must specify the product(s), quantity, and the exact price

2. Valid business purpose

- Fixing price and supply

3. No material distortion of income

➤ Remember other expenses!



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Income Averaging

- Filed on Schedule J
- Allows taxpayers to utilize unused tax brackets from previous 3 years



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Income Averaging

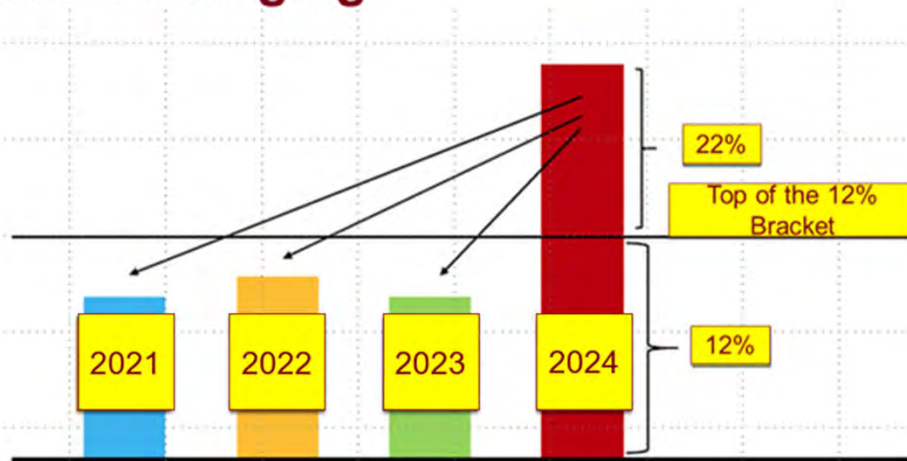
- Only farm income qualifies
- Does not affect:
 - Self-employment income or tax
 - Taxable income



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Income Averaging



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Defer Crop and Livestock Sales

- Postpone sales into next year. Income is taxable upon receipt.
 - Constructive receipt rules
- Transfer of ownership and telling the buyer to hold the check does not work. Must do a deferred payment contract (next slide).

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Deferred Sales (Deferred Sales Contract)

- Allowed under installment sale rules
- Producer must have binding contract with buyer
- No constructive receipt of income
- Seller is an unsecured creditor
- **Risk**
 - If the buyer or seller goes out of business before payment

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Depreciation

- Section 179
 - Class life 3-15 qualifies
 - 2024 Max. is \$1,220,000
 - Qualifying Purchase limit = \$3,050,000
 - Above purchase limit, dollar for dollar reduction of allowable expense.
 - Related party rules (prohibited for lineal descendant).

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Depreciation

- Bonus Depreciation (Additional first year depreciation)
 - Class life 3 to 20-year property qualifies
 - New or Used (must be Qualifying Acquisition)
 - For 2024, 60% deduction (Last year for 80%)
 - Default is to take bonus. Must elect out by class life.
 - Related party rules same as Section 179.
 - Lineal Descendant not eligible

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Tax Planning



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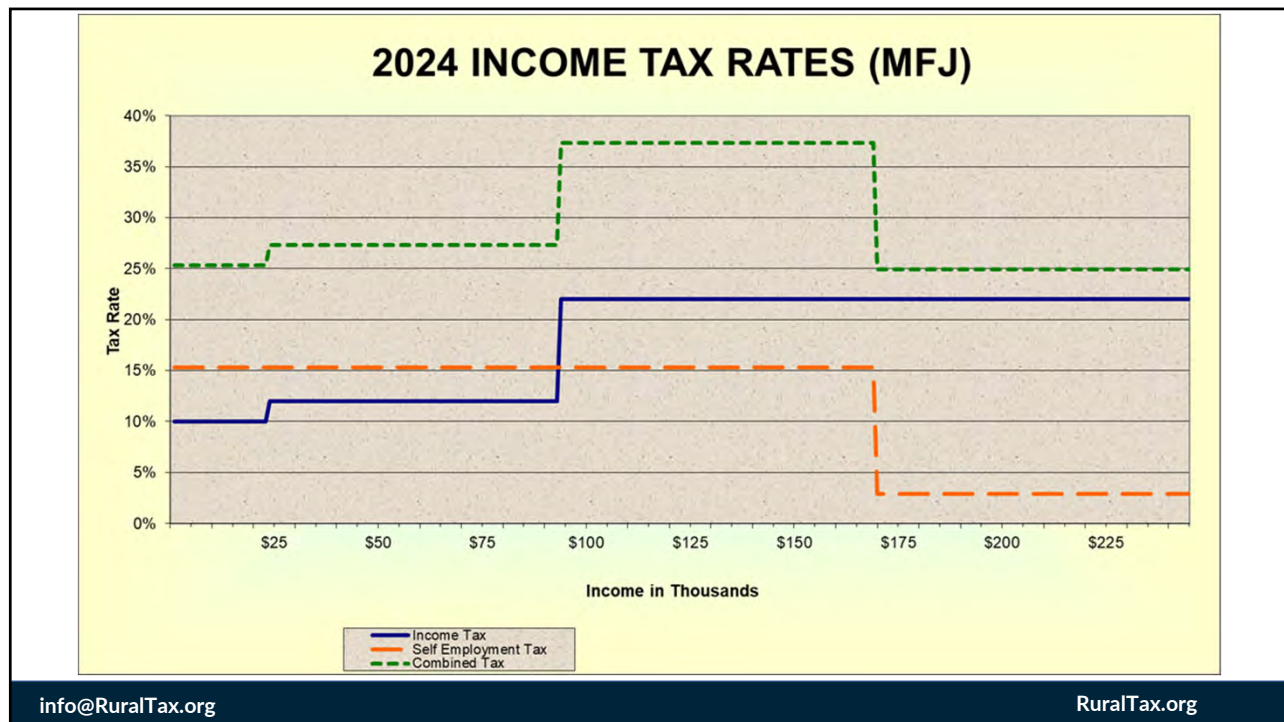
Tax Planning Example

At the beginning of tax planning, the farmer brings in their accounting records, and they have a projected schedule F of \$200,000. After taking regular deductions (standard deduction, qualified business income deduction, and half the SE tax), the income tax liability is as follows.

- Taxable Income = \$126,135
- Federal Tax = \$17,856
- Self-Employment Tax = \$26,262
- Total Tax = \$44,118
- Marginal Tax Rate = 22%

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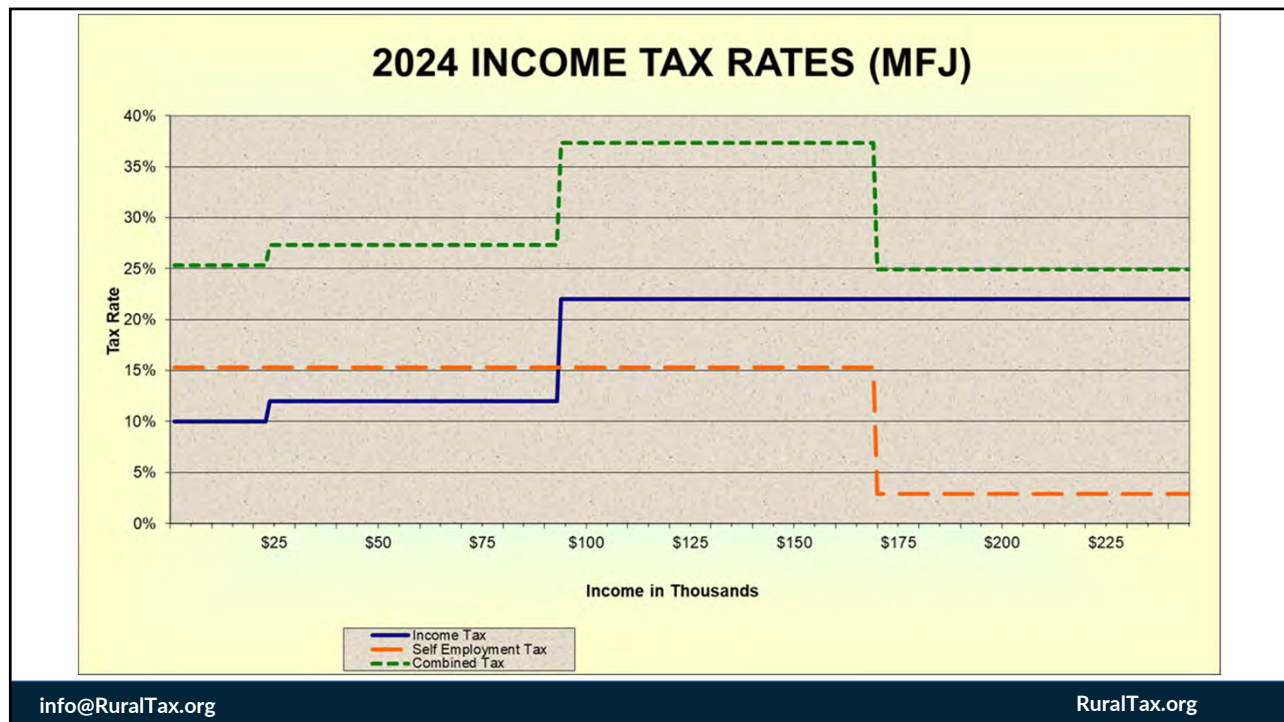
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Tax Planning Example (Continued)

To mitigate this income tax liability, the producer is going to pre-pay \$20,000 of 2025 crop inputs and is also going to take \$22,000 of Section 179 on a recently purchased piece of equipment. This adds \$42,000 to the current farm expenses and reduces schedule F to \$158,000. After the additional expense, the tax liability is:

- Taxable Income = \$94,110
- Federal Tax = \$10,831
- Self-Employment Tax = \$22,324
- Total Tax = \$33,155
- Marginal Tax Rate = 12%



Tax Planning (Continued)

The net change to the tax liability is listed below.

- The farmer spent an additional \$42,000 in pre-payment and accelerated depreciation.
- The farmer cut the tax bill by \$10,963.
- The farmer saved \$0.261 of tax for every dollar of pre-payment and accelerated depreciation.
- Qualified Business Deduction (QBI) was reduced with increased expenses.

Thank You!



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