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Neil Harl
Iowa State University, harl@iastate.edu

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INCOME ASSURANCE:
ARE RECOVERIES DEFERRABLE?

— by Neil E. Harl

The latest wrinkle on crop insurance, taking crop revenue into account as well as yield, represents a significant extension of traditional crop insurance concepts. A major issue is whether proceeds of such revenue assurance policies are eligible for the one-year deferral available under federal income tax law.

One-year deferral for crop insurance proceeds

In general, proceeds from insurance, whether from hail, fire or drought damage, are includible in gross income in the year actually or constructively received. In effect, destruction or damage to crops and receipt of insurance proceeds are treated as a “sale” of the crop.

However, under a special provision, taxpayers on the cash method of accounting may elect to include crop insurance and federal disaster payments in the year following the year of crop loss if, under the taxpayer’s practice, income from sale of the crop would have been reported in the later year. Crop insurance and disaster payments must be treated the same if received in the same taxable year.

The one-year deferral provision applies to payments made because of damage to crops as well as the inability to plant crops. The deferral rule extends to payments received because of drought, flood or “any other natural disaster.”

In order to defer crop proceeds and disaster payments, the taxpayer must establish that a substantial part of the crop (more than 50 percent) would have been reported in the following year. A taxpayer may not elect to defer only a portion of the insurance proceeds to the following year. It is not completely clear how crop insurance and disaster proceeds are reported for a crop normally sold at harvest if other crops are normally carried over to the following year but it would seem that the proceeds of a crop normally sold at harvest could not be deferred.

Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

The election to defer is made by attaching a separate, signed statement to the income tax return for the year of crop damage or destruction or on an amended return. An election counts only for the tax year in which made; application to revoke the election must be made to the District Director. One election covers the insurance proceeds attributable to all crops representing a trade or business.

Eligibility of income assurance payments for deferral

To the extent that crop insurance proceeds are not eligible for the one-year deferral, farmers may experience a “bunching” of income. The proceeds from the preceding year’s crop and the proceeds from the insurance on the current year’s crop may both be taxable in the same year.

Unless the Internal Revenue Code is amended, it would appear that the proceeds from revenue assurance policies would not be eligible for the one-year deferral. The regulations clearly contemplate that, to be eligible for deferral, crop insurance proceeds must be received as a result of “destruction or damage to crops.”

The regulations specify that—

“for the purposes of this section only, federal payments received as a result of destruction or damage to crops caused by drought, flood, or any other natural disaster, or the inability to plant crops because of such a natural disaster, shall be treated as insurance proceeds received as a result of destruction or damage to crops.”

In further elaboration of the scope of the deferral provisions, the Internal Revenue Service has stated that—

“In order for payment to constitute insurance for the destruction of or damage to crops, the insured must suffer actual loss.”

IRS has further stated—
“Agreements with insurance companies that provide for payments without regard to actual losses of the insured, e.g., in the event that certain weather conditions occur or do not occur, do not constitute insurance payments for the destruction of or damage to crops. Accordingly, payments under such contracts will not qualify for deferral under section 451(d) of the Code.”

The latter provision prevents the proceeds from so-called “rain insurance” policies from being eligible for deferral.

In light of these authorities, it appears that the proceeds from crop insurance policies involving revenue assurance will not be considered eligible for deferral under current law. An amendment to Section 451(d) of the Internal Revenue Code will be necessary to make such proceeds eligible for deferral. Without such an amendment, revenue assurance is likely to be less popular than would be the case if the proceeds were eligible for deferral.

**FOOTNOTES**


**CASES, REGULATIONS AND STATUTES**

by Robert P. Achenbach, Jr.

**BANKRUPTCY**

**FEDERAL TAXATION-ALM § 13.03[7].**

**ALLOCATION OF TAX PAYMENTS.** The debtor was a part owner of a corporation which had failed to pay employment taxes. The corporation entered into an installment payment agreement with the IRS for payment of the taxes and penalties. As part of that agreement, the debtor agreed to be liable for the 100 percent penalty as a responsible person in the corporation. The installment agreement did not provide for any allocation of the payments between the tax debt and the penalties and interest on the debt. The debtor, in the debtor’s case, moved to require the IRS to retroactively allocate the installment payments first to the tax debt and then to the penalties and interest. The court denied the motion for two reasons: (1) the court did not have any authority to make rulings involving the corporation because the corporation was not a debtor in this case, and (2) the court had no authority to make retroactive allocation of tax payments, especially where the tax payments were not made with a specific allocation request by the taxpayer. In re Kaplan, 104 F.3d 589 (3d Cir. 1997).

**DISCHARGE.** In a Tax Court case involving the debtor’s 1988 income taxes, the Tax Court held that the debtor was liable for fraud penalties in connection with the taxes owed. The debtor then filed for bankruptcy and sought to avoid the 1988 taxes. The court held that the Tax Court ruling was to be given collateral estoppel effect in the bankruptcy case because the Tax Court made a specific ruling of fraud based on a higher standard of proof; therefore, the 1988 taxes were nondischargeable under Section 523(a)(1)(C). In re Mitchell, 97-1 U.S. Tax Cas. (CCH) ¶ 50,268 (Bankr. C.D. Calif. 1997).

**DISMISSAL.** When the debtor filed for Chapter 13, the debtor had not filed income tax returns for 1987 through 1994. The Bankruptcy Court ordered the debtor to file the income tax returns as a condition for confirmation of the plan. The debtor filed the returns but put zeros in all lines of the return. The debtor argued that the IRS had no authority to tax income or to require income tax returns to be filed. The Bankruptcy Court dismissed the case for failure to comply with an order of the court. The District Court ruled that, because the debtor had clear notice of the court order and sufficient time to comply, the Bankruptcy court acted reasonably in dismissing the case for failure of the debtor to comply with the court-ordered filing of the returns. Jablonski v. I.R.S., 204 B.R. 456 (W.D. Pa. 1996).

**CONTRACTS**

**NONACCEPTANCE OF GOODS.** The defendant, a landscaping contractor, ordered several types of ornamental trees from the plaintiff to be sent COD. When the trees arrived at the defendant’s business, the defendant paid only the shipping charges, at the acquiescence of the plaintiff.