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Farm Flood Losses and Income Taxes

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Many Vermont farmers have had very significant losses of crops and property from the flash flooding we have had this year. In addition, the Food and Drug Administration is really concerned about the possible contamination of our food supply from flood waters. This concern is likely to make losses suffered by Vermont farmers even greater. Flood waters may have carried sewage from septic systems and from flooded sewage treatment plants, fuel oil or gasoline, oils from downed electrical transformers, and any manner of other "stuff."

Farmers are facing losses from:

- Destroyed food and feed that was washed away.
- Unsalable product -- food or feed that was flooded and may be still in the field.
- Unharvestable product -- vegetables, hay, or corn that has debris in the field or is heavily silted and will not be harvested.
- Unfeedable product -- pasture, hay, or corn that may have "adulterants" on it, or be moldy and have mycotoxins in it from the mold.
- Livestock, machinery, and equipment that was damaged or washed away.
- Damaged buildings and damaged land.

FDA does not want contamination of our food supply. Here is a link to a recent UVM Extension fact sheet about food safety after the flood for commercial vegetable growers, *Post-Flooding Produce Safety for Commercial Produce Growers*. Here is a link to a recent UVM Extension fact sheet about flood damaged crops and forage, *Managing Flood Damaged Crops and Forage from Tropical Storm Irene*.

The Farm Service Agency (FSA) has been collecting information about flood damage to farms, and total acreage flooded. There are discussions about some type of flood relief to farmers who have suffered losses. There are some NRCS programs that can help. The VT Community Foundation is making grants to qualified flooded farmers; the "Vermont Farm Disaster Relief Application" is the way to apply. There are a number of financial resources available to farmers which are explained on the Vermont Agricultural Credit Corporation Assistance factsheet, but none are as good as selling farm production.

In terms of income taxes, our tax system is set up to tax income, profit, and gain. The value of products lost or ruined are not subtracted from income, but are represented as zero sales with the usual amount of production expenses. This makes profits less, so taxes are less. This is just what happens when a round bale of hay spoils or you have a bucket of unsalable tomatoes, it gets tossed into the compost or manure pile, and there is no income. Unfortunately, many of the losses that farmers are facing due to the recent flooding are treated just like that. A number of farms are looking at lost income or lost feed or damages of $100,000 or more.

A quote from an article at RuralTax.org says, "Many taxpayers are surprised to learn that losing property in casualties, thefts, or disasters often does not result in the deductible income tax loss that they expected. However, special income tax provisions do provide some tax advantages. These provisions may allow taxpayers to postpone reporting taxable gain or to accelerate reporting tax losses. Making optimal use of these special provisions can take some of the economic sting out of the unexpected loss of property."

Some farmers were covered by Crop Insurance. Like many insurance policies, crop insurance has a deductible. Usually the payments from this insurance will cover the cost of getting the crop into the ground, NOT the value of the crop had it been harvested and sold. Crop Insurance has an Adjusted Gross Revenue policy (rma.usda.gov) that insures gross revenue (total sales) for farms with several products. The insurance deductibles range from 65-85% (see *Adjusted Gross Revenue*, http://www.rma.usda.gov/pubs/rme/agr.pdf). Money from crop insurance is counted as farm income. Farmers who receive a benefit from crop insurance have a couple of decisions to make about how to claim the income. Take a look at the *Farmer's Tax Guide*, page 10-11, Chapter 3, Farm Income (http://www.irs.gov/pub/irs-pdf/p225.pdf).

IRS says that "income losses" are not deductible. This hurts. See *Farmer's Tax Guide*, page 66, "Farming Losses - Example," Chapter 11 (http://www.irs.gov/pub/irs-pdf/p225.pdf).

If you lost depreciable property in the flood, there are calculations that must be done to figure the deductible "casualty loss" (a casualty loss is the result of an unexpected event-fire, storm, accident, etc.). These calculations involve the adjusted basis of the property, the salvage value of the property, and any insurance you have received. See *Farmer's Tax Guide*, page 66, Chapter 11. Casualty losses can be no greater than the tax basis of the property lost (not the fair market value). IRS Form 4684 is the form to use for claiming a "casualty loss."

Proper tax treatment of losses from a disaster is not simple. Luckily we do not have to face it every year. It requires good records and understanding. If you have a loss from the flood, it would be a good idea to talk to a tax practitioner with farm tax experience, and maybe hire them to prepare your taxes for you in this unusual year.

For farmers who are in a Federal Disaster Area (most of Vermont), the *Farmer's Tax Guide* has information about handling "casualty losses." Farmers with such a loss can make a choice to claim the loss on the *previous* year's taxes by filing an amended return -- this could mean a tax refund. See *Farmer's Tax Guide*, page 71-72, Chapter 11, "Casualties, Thefts, and Condemnations" (http://www.irs.gov/pub/irs-pdf/p225.pdf).

If you have to sell livestock because of a flood (or other weather-related condition), handling this for taxes is described in *Farmer's Tax Guide*, Chapter 3, page 8, "Farm Income – Weather Related Conditions." The benefit provided is to postpone the gain from the sale of the livestock until the next tax year. If the livestock was held for draft, dairy, sport, or breeding, you may have a 2-year period to reinvest the money from the sale in similar livestock. (In Disaster Zones this can be as many as 4 years.) This is called an "involuntary conversion," and is described in detail in the *Farmer's Tax Guide*, Chapter 11, "Involuntary Conversions," pages 68-70. Or take a look at an easier to understand article at RuralTax.org, "*Weather-Related Sales of Livestock*."

At least one organization (VT Community Foundation) is offering grants to qualifying farmers after the flood. These could be non-taxable gifts. Take a look at *Farmer's Tax Guide*, Chapter 11, page 67, "Disaster Relief," and also page 71, Disaster Relief grants and payments. If your family received grants, you might look at *Your Federal Income Tax* (irs.gov pub 17) Chapter 12, page 90, Public Assistance Benefits.

Hopefully, you will be able to pull your farm into next year with no more major problems.