FARM Library

Financial and Risk Management Database

Improving farm management skills one topic at a time

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Casualty Losses

What are Casualty Losses

Casualty losses are an area of the tax code that we thankfully don't have to deal with very often but when they occur they can be a major event in the life of a farming operation.

A casualty occurs when "property is damaged, destroyed, or lost due to a sudden, unexpected or unusual event". You may have taxable losses or gains when a casualty occurs to assets within your farming business, even if there is only partial damage. Deductibles losses can be incurred by many events including, vehicle accidents, fires, floods, freezing, lightning, tornados, terrorist attacks and others. These losses are not deductible if you willfully caused them (vehicle accidents, fires, etc.) or if you paid someone else to create them.

Crop and Livestock Losses

If damage occurs to crops and livestock raised for sale or raised draft, dairy or breeding livestock, there is generally no deduction for losses as a cash basis taxpayer. Since the cost to raise those products has already been deducted, your basis is zero in the product so there is nothing to deduct. If you are an accrual basis taxpayer, the loss is calculated in your inventory change.

If you receive crop insurance for crop damage, replant or payment for grain lost prior to sale, the income is taxable on Schedule F, just like the sale of the crop itself. You may be eligible to defer to income from crop insurance to the year following production if your normal business practice is to sell the grain in the year following production. There are no deferral options for livestock insurance or the sale of livestock due to casualty other than drought, flood or other weather related condition.

The cost of purchased feeding livestock that die due to a casualty is deductible when they die.

Buildings, Equipment and Purchased Breeding Livestock Losses

You may be able to claim a deductible loss for assets that you must depreciate, such as buildings, equipment and purchased breeding livestock that are completely destroyed by a casualty. A calculation to determine if your adjusted basis (purchase price – depreciation taken) is greater than any insurance or other reimbursement you receive or expect to receive must be made. If your adjusted basis is higher, you have a loss. If it is lower, you may have a taxable gain to report.

Generally, the gain or loss must be calculated separately for each item damaged in the casualty. For example, a machine shed was destroyed by a tornado and a tractor and combine inside were also destroyed. The following shows their individual calculations:

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	Purchase Price	Depreciation Taken (-)	Remaining Basis (=)	Insurance Settlement	Gain/Loss
Machine Shed	$100,000	$75,000	$25,000	$50,000	$25,000
Combine	$200,000	$200,000	$0	$175,000	$175,000
Tractor	$80,000	$8,000	$72,000	$70,000	(-$2,000)

Assets that are partially destroyed are also eligible for a casualty loss. To determine the loss, you must determine the fair market value of the asset immediately before and immediately after the event. You generally need a competent appraiser to determine these values but you can use the cost to clean up or repairs if you actually make the repairs, the repairs are necessary, it is not excessive, the repairs fix the damage only and the value after the repairs is not more than the value prior to damage. This loss again must be offset by any insurance or other compensation you receive for the asset before claiming a casualty loss.

Personal Assets

Personal assets have different rules than farm assets. There are deduction limits, both on a per asset basis and a total overall limit. Insurance settlements for personal assets should be kept separate from those for your farm assets. You may be eligible for deductible casualty losses on your personal property as well as your farm property. It is important in a casualty that causes both farm and non-farm losses, that you keep track of the expenses to replace or repair the asset separate.

Postponing Gain

You can generally postpone recognition of the gain for two years, if you plan to replace the property with like-kind property. For example, you had a grain bin was destroyed by a tornado in 2014. You plan to replace it, but the company was unable to have it built within the year. You can defer that gain until you can get it built (before 2016). At that time, your basis in your new grain bin is:

- Basis in Old Grain Bin
- (-) Insurance Payment
- (+) Cost of new Grain Bin
- (=) Basis in New Grain Bin

If you are unable to replace the property within the two years, you must amend the original return and recognize the gain that year.

You cannot postpone the gain if you are buying the replacement property from a related party and you are a c corporation, a partnership in which 50% is owned by a c corporation or you had over $100,000 of gain in the tax year. Also, if the taxpayer dies after electing to postpone the gain but before the replacement property is purchased, the taxpayer must recognize the gain on the tax return for the year in which the gain is received.

The two year rule is general rule. There are often different replacement periods for areas under Federally Declared Disaster Areas, or if drought caused the sale of breeding livestock.

Alternative Strategies

It may make sense to not elect a casualty loss, but rather recognize the insurance settlement as income and the replacement property as an outright purchase. This should be evaluated on an individual basis as tax brackets, Section 179 limits, Net Investment Taxes, Self-Employment taxes, etc. all have an impact on this decision. Working together with your tax preparer early after a casualty will be an important part of figuring out the best strategy for your farming business.