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. However, 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 a taxable loss or gain when a casualty occurs to assets within your farming business, even if there is only partial damage. Deductible 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 income from crop insurance to the next tax year 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 a casualty other than drought, flood, or other weather related conditions.

The cost of purchased feeding livestock that die due to a casualty is deductible at the time of death.

Buildings, Equipment, and Purchased Breeding Livestock Losses

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

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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:

	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 after the event. You generally need a competent appraiser to determine these values. However, you can use the cost to clean up, or the cost of repairs made as long as the repairs are necessary, not excessive, made to fix the damage only, and the value after the repairs does not exceed the value prior to damage. Again, this loss must be offset by any insurance or other compensation you receive for the asset, before claiming a casualty loss.

Personal Assets

Personal assets have a different set of rules than farm assets. From 2018 through 2025, personal casualty losses are not deductible unless you are in a Federally Declared Disaster Area (see map). Insurance settlements for personal assets should be kept separate from those for your farm assets. In the event of a casualty that causes both farm and non-farm losses, it is important that you keep track of the expenses to replace or repair the asset separately.

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, a grain bin was destroyed by a tornado in 2019. You plan to replace it, but the company was unable to have it built within the year. You are able to defer that gain until the new grain bin can be built, keeping in mind it must be done before the end of 2021. At that time, the basis in the new grain bin is:

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

If the property cannot be replaced within the two year timeline, you must amend the original return and recognize the gain in the year of the casualty.

You cannot postpone the gain if you are buying the replacement property from a related party, 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 a 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 not to 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 with your tax preparer early after a casualty will be an important part of figuring out the best strategy for your farming business.

Record Keeping

The most important task after a casualty is to keep good records of everything you've spent and everything you've received. This includes federal loans and grants, insurance proceeds, and donations received. Not all of these are taxable, but it is important to know what everything was for. These times are always stressful and records are often far from your mind, but keeping everything organized will keep tax time from being worse than it has to be.