Recurring Tax and Legal Issues for Farmers and Ranchers

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Overview

I receive many questions from farmers, ranchers and others. Some issues are recurring, and others are cyclical. Of course, lease and fences come up over and over, as do tax questions. Of course, the questions abound practically daily about deducting residual fertilizer supply. Some businesses are really pushing the concept in light of the lack of guidance on the topic and are even calling it the "Section 180" deduction – which it is not. That's the Wild, Wild, West of tax right not.

Recently, I have had questions come in about how to report crop insurance proceeds on the tax return, how to get out of an irrevocable trust, when depreciation can first be claimed and paying estimated tax as a farmer.

Recurring (and recent) tax and legal issues impacting farmers and ranchers – it's the topic of today's post.

Proper Reporting of Crop Insurance Proceeds

Many farmers have elected to defer the yield portion of crop revenue insurance policies for the last few years. But can the revenue portion be deferred for tax purposes?

In general, crop insurance proceeds are includible in gross income in the year actually or constructively received. But if you are on the cash method of accounting you may elect to include crop insurance proceeds in income in the tax year following the crop loss if your normal practice is to carry more than 50 percent of crop sales into the following year. If multiple crops are involved, that 50 percent test must be met with respect to each crop if each crop is associated with a separate business.

Because the deferral provision only applies to insurance payments received on account of physical damage to crops, the deferral rule is tricky to apply to crop insurance that pays out based on low price or yield. With revenue protection, yield protection or group risk policies, only the portion of the payment that is attributable to physical loss is deferrable. Once you know your approved yield, the base price, the harvest price, the insurance coverage level and the revenue guarantee, there is an approach for calculating the deferable amount based on yield loss. However, any amount based on the decline in price from planting to harvest is not deferable.

Decanting a Trust

Trusts are a popular part of an estate plan for many people. They also come in different forms. Some take effect during life and can be changed whenever the grantor desires. Other trusts also take effect during life but can't be changed when desired. Or at least not as easily. That's a question that I was recently asked – how can I get out of an irrevocable trust?

If your estate plan includes an irrevocable trust, can you change the trust if your circumstances or the law changes? What if there was a drafting error that wasn't discovered until after the trust was executed? The concept of "decanting" involves distributing the assets of one trust to another trust that has the terms that the grantor desires and without the terms that the grantor no longer wants.

The ability to "decant" comes from either an express provision in the trust, or a state statute or state court opinions. Presently, over 30 states have adopted "decanting" statutes, and a handful of others (such as Iowa and Kansas) allow trust modification under common law. Some of the courts have determined that decanting is allowed based upon the notion that the trustee's authority to distribute trust corpus means that the trustee has a special power of appointment which allows the trustee to transfer all (or part) of the trust assets to another irrevocable trust for the same beneficiaries.

If you have an irrevocable trust, you just might be able to change it if you need to.

When Can Depreciation First Be Claimed?

A business asset can begin to be depreciated in the year that it is placed in service. But what does "placed in service" mean?

Depreciation on a business asset can start in the year the asset is placed in service. That means the year that the asset is ready and available for use in your trade or business. For example, what if you sign a contract for a new farm building to be built on your farm. You pay an up-front amount, and the company delivers materials to your barnyard late in the year to be constructed after the first of the new year. Can you claim depreciation on the building for the year in which the materials were delivered? The answer is, "no." That building is not ready and available for use in your farming business as of the end of the year. It's not a building at all. Just having lumber and other building materials laying in a pile at your farm is not good enough to start claiming depreciation.

It's the "ready and available for use" factor that is the key and it can work in reverse. What if you buy a tractor or other type of farm machinery late in the year? As of year-end it's still at the dealer, but it's all serviced and ready for you. That tractor is ready and available for use as of the end of the year and depreciation can be claimed for that year. It doesn't matter that you didn't use it during the year.

This can be a big issue because of the "fast" methods of depreciation. It will be a bigger issue if Congress restores 100 percent first-year "bonus" depreciation.

Farmers and Estimated Tax

A farmer can make one estimated tax payment each year by January 15 or can elect to file and pay 100 percent of the income tax liability by March 1. But qualification as a "farmer" is critical.

To be a farmer for estimated tax purposes, a taxpayer must have at least two-thirds of gross income from farming. Some items of income don't qualify as farm income such as gains from selling or trading farm equipment. Also, cash rent income does not qualify as farm income, but income from selling livestock does.

This could mean that some taxpayers will no longer be "farmers" for estimated tax purposes. But, if you qualified in 2024, you automatically qualify in 2025. If you didn't qualify in 2024, then make sure you don't have too much non-farm income.

If you won't qualify as a farmer and you didn't make any estimated tax payments, the interest rate for the penalty calculation will be 7 percent for the second quarter of 2025.   Also, since you no longer are a farmer, you must pay 100 percent of your 2024 tax or 90 percent of 2025 tax. This can easily result in an estimated tax penalty of over $1,000 if you aren't careful.

If you think that this might apply to you, make sure to review it with your tax advisor sometime before year-end to see what options are available to you.