



CALIFORNIA
FARMLINK

Tax Issues Caused by Disaster or Catastrophe

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2. Property Loss - Disaster and Casualty Losses
3. Operating Loss
4. Special Rules for Conservation Recovery
5. Insurance and Other Income
6. Special Rules for Livestock
7. Additional Resources

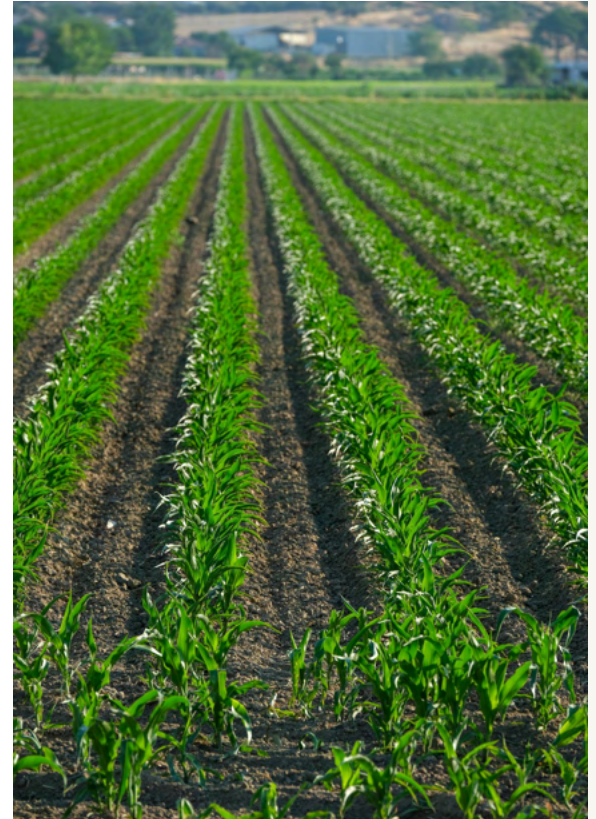


Federal and State Income Taxes

Generally California State Income Taxes start with the federal income tax returns and then require adjustments to decrease some federal deductions, and allow for some special California deductions and credits.

Other states with state income tax generally do the same.

This presentation only covers Federal Income Taxes.

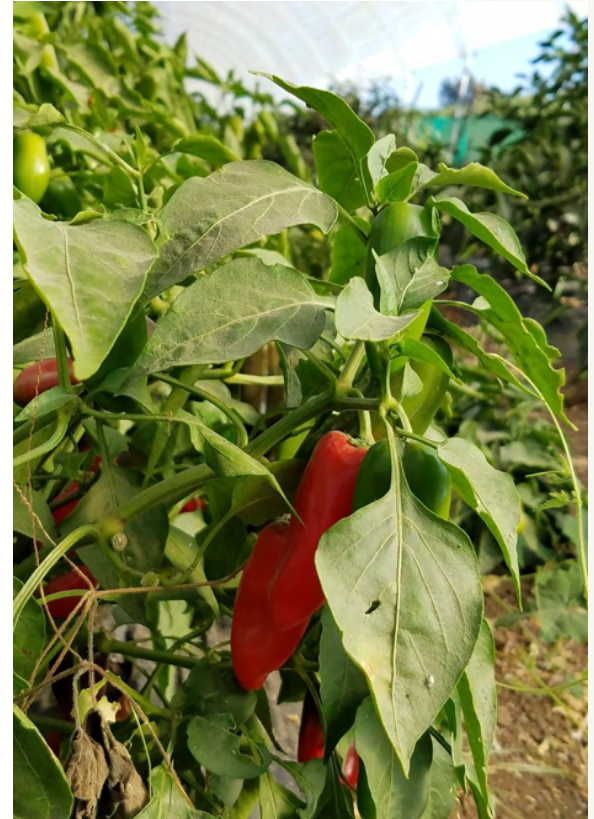


Disaster and Casualty and Loss of Property or Income



Disaster and Casualty

- A **disaster** is a **sudden unexpected event** that **happens to a lot of people**. It is large enough that government officials activate resources to assist the affected community. It may be declared a disaster at the local, state or federal level.
- A **casualty** is a **sudden unexpected loss of property** due to an event that **happens just to you or a few people**.



Property Helps Create Income

- **Business property (also called assets)** helps generate revenue. Business property benefits multiple years.
- **Business income** is earned in the ordinary course of business.
 - **Gross income** is revenue before expenses are deducted.
 - **Net income** is revenue minus expenses.
 - **Expenses** help to generate revenue, but only benefit the current year.



Net Business Income

Gross Business Receipts

Less: Ordinary and Necessary Expenses

Equals Net Business Income (or Loss)

Net Income is also called **operating income/loss** or **ordinary income/loss**.

For a sole proprietor or a partner it is also called **ordinary income subject to self-employment tax** because the income is **subject to both income tax and self-employment tax**.



Capital Gains Income (Loss)

Asset purchases and sales are reported separately from regular business activity.

- Proceeds from selling business property aren't counted as gross receipts, and purchase costs aren't treated as business expenses.

Capital Gains Income (Loss) is the net gain or loss from sale of business property.

- It is included in taxable income, taxed at a **lower rate**, and **not subject to self-employment tax**.



Taxable Income Review

Farm Income on the 1040:

- Salary from S-Corp owned by taxpayer
- Farm/Ranch **operating income (loss)**
 - Schedule F (sole proprietor, qualified marital joint venture)
 - Schedule E (K-1 received from a farming partnership/LLC)
- Form 4797 **Sale of Business Property**
- Form 4835 Farmland rental (crop share)

* Note that **operating income / loss** and **sale of property** are reported on different forms.

That's because totally different rules apply!

Property Loss and Operating Loss

- **Business Property Loss:** *Destroyed or damaged business asset.*
- **Operating Loss:** *Income from normal business activities is less than ordinary and necessary expenses needed to support normal business activities.*
- **Business property losses** create **capital gains or losses**. These are **taxed at a lower rate** and there are **special rules limiting losses**.
- **Business operating losses** affect **income tax and self employment tax** and may be carried forward or backward.

Taxable Income - Disaster / Casualty Effects

Farm Income on the 1040:

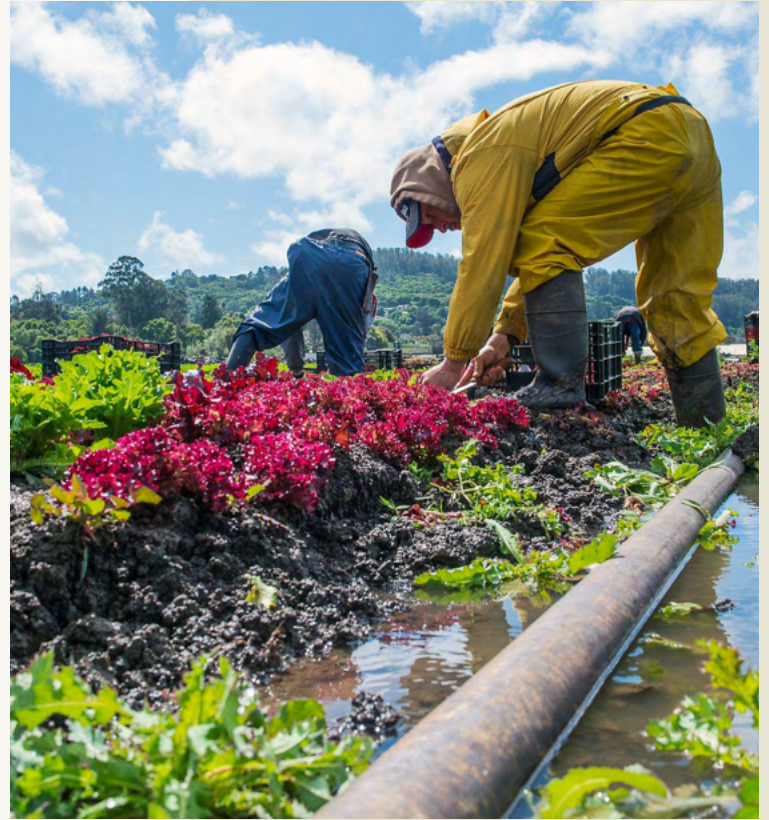
- Salary from S-Corp - *reduced if operations are affected*
- Schedule F - *reduced if operations are affected*
- Schedule E
 - K-1 *reduced if operations are affected*
 - Farmland rental *may be reduced*
- Form 4797 Sale of Business Property - ***gains if assets are sold in response to disaster, or if insurance payment exceeds basis, losses if basis exceeds amount realized***
- Form 4835 Farmland rental *may be reduced*

Four Types of Disaster-Related Tax Losses

Federal tax law has special rules for:

- **Business Property Disaster Losses** due to a **federally declared** disaster.
- **Business Property Casualty and Theft Losses** from non-disaster **sudden and unexpected events or theft.**
 - The tax rules for theft are the same as for casualty so we will just talk about casualty from here on.
- **Business loss** (negative business income).
- **Personal casualty loss** limited deduction only applicable for loss of non-business property due to federally declared disaster.

Property Loss - Disaster and Casualty Losses



Assets

Assets benefit multiple periods.

- The IRS requires **capitalization** - capitalization is IRS for “special rules about how much and when you may deduct”

Depreciable Assets are assets that have an ascertainable life - that’s IRS for “we can ascertain that one day it won’t exist”

- If an asset is depreciable then you may use an allowable **IRS tax life** and **depreciation method** to calculate the **depreciation deduction** allowed each year.



Capital Gains Income or (Loss)

	Sales price
Less:	Adjusted Tax Basis*
<hr/>	
=	Capital Gain (Loss)

***Adjusted Tax Basis is Original Basis** reduced by the depreciation taxpayer deducted or should have deducted.

***Original Basis is:**

- Purchase basis (what taxpayer paid to purchase it)
- Capitalized cost basis (what taxpayer paid to develop the asset)
- Gift basis (basis in hands of donor becomes donee's basis)
- Inherited or stepped-up basis (fmv at date of death or 6 mo. later)

Casualty Loss

For property lost due to casualty, the capital gains loss is the **lesser of the adjusted tax basis OR the decline in fair market value due to the event**, reduced by any insurance proceeds

Sales price/Insurance Proceeds

Less: Lesser of **Adjusted Tax Basis** or **Decline in FMV**

= Casualty Loss (Capital Loss due to Casualty)

Fair Market Value (FMV)

If the property is restored / repaired the cost of the restoration or repair can be used as the measure of the decline in FMV, otherwise you will need an appraisal, or to document comparable sales.

Loss of Fully Depreciated Destroyed Asset

Sales price = 0

Less Adjusted Tax Basis* = 0

= Capital Gain (Loss) = 0

***Basis**

Original purchase price = 1,000

Less Depreciation Taken = 1,000

Basis at time of loss = 0

No loss is allowed on fully depreciated property.

Gain on Sale of Damaged Asset

Salvage sales price =	\$10,000
Less Adjusted Tax Basis* =	5,000
<hr/>	
Capital Gain =	5,000

If you have a tax gain from an involuntary asset loss **you may delay recognizing the gain as taxable income if you use the proceeds to restore or replace the original property.** Seek additional information regarding **IRC 1033** and the assistance of a qualified tax preparer.

***Basis: Original purchase price = \$20,000 Less depreciation taken = \$15,000 - Adjusted Tax Basis at time of loss = \$5,000**

Loss on Non-Business Investment Assets

Capital Gain/(Loss) from - **non-business investment assets:**

- Gains are taxed as capital gains
- **Losses are limited to \$3k/year**
- Losses may be carried forward until used, subject to the 3k/year limit

Non business investment assets may include property you rent out to others.



Loss on Business Assets

- Gains are taxed as capital gains
- **Losses are fully deductible against ordinary income**
- Losses in excess of ordinary income may contribute to a **net operating loss** and be carried forward until fully used against future income.



Disaster Losses

Casualty losses associated with a federally declared disaster are called **disaster losses**.

Disaster losses may be claimed in the year PRIOR to the actual loss **by amending the prior year return**.

This allows the taxpayer to quickly receive a refund of prior year taxes instead of waiting to report the loss when the tax return is due.

Taxpayers may also take a limited casualty loss deduction for **non-business property losses** caused by a federally declared disaster.



Special Rules for Livestock

There are special rules for weather-related sales of livestock.

See FarmLink Tax Toolshed Lesson 6.6.a



Operating Loss



Lost Sales

One of the most common types of losses is loss of ability to sell.

- Road closures
- Worker evacuations/displacement
- Loss of product

This type of loss is simply recorded as decreased income. It contributes to your annual operating loss. It is not a separate type of loss. There is no special tax treatment.



Clean Up and Recovery Costs

Generally clean up and recovery costs will be treated the same as normal farm operations and asset development costs regardless of the fact that they were caused by a casualty or disaster.

- Expenses benefit the current period and are deducted in the current year
- Assets benefit future periods and are capitalized and then you may take an annual depreciation deduction using your choice of allowable IRS methods.



Expenses in Excess of Income = Loss

- Expect this in a disaster/catastrophe year.
- **Loss from one business may reduce positive income from other businesses or salary and eliminate taxes.**
- **But, total losses are limited** to an inflation adjusted amount set each year (\$313,000 single / \$626,000 joint for 2025).
- Losses in excess of the amount needed to eliminate any tax owed, or in excess of the annual limits are **called Net Operating Losses (NOLs).**



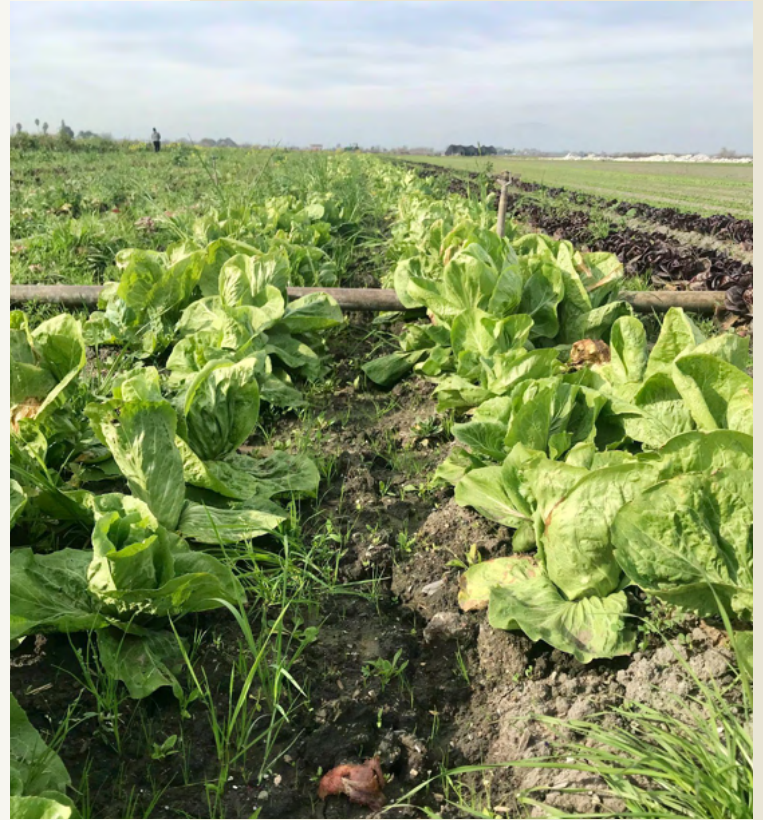
NOL Carryforward / Carryback

Business NOLs can be carried forward indefinitely with minimal limits on use.

- Casualty losses on business property are included in the total business NOL.
- Prior to 2020 could be carried back two years.
- The two year carryback is **still allowed for farming, ranching, and fishing income** (not any related processing or agri-tourism, etc).

To take advantage, file a prior year amended return, reduce taxable income in that year by the carryback, and claim a refund for excess tax paid in the prior year.

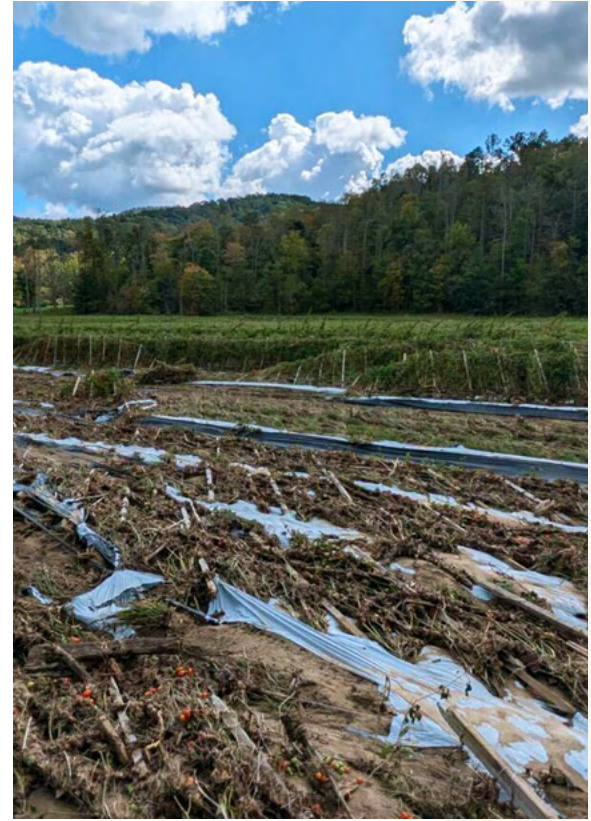
Special Rules for Conservation Expenses for Recovery



Conservation Practices - Expenses or Assets

It is an asset if most of the economic benefit is to future years.

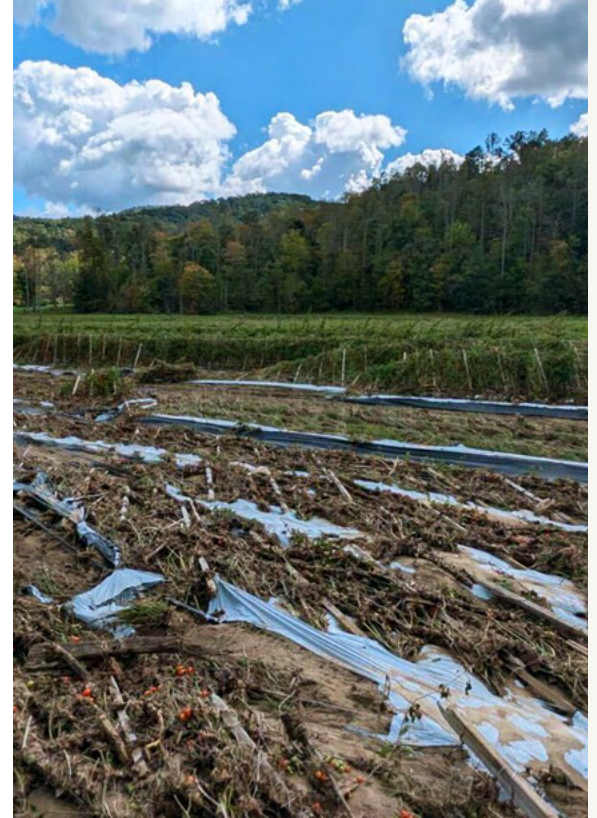
- You can **not** deduct the full cost in the current year, you have to **depreciate** the cost over the **ascertainable useful life** of the asset.
- OR - there are special rules for deducting assets installed as part of an NRCS-approved plan (more in a moment).



Conservation Practices - Expenses or Assets

It is an expense if you can show that it is ordinary and necessary and **primarily benefits your current year operations.**

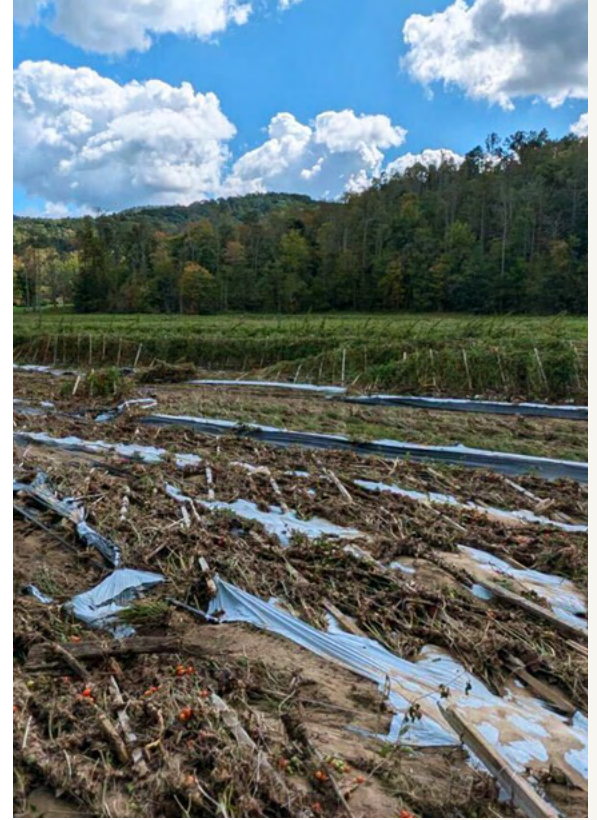
- There may be a lingering benefit to future years, but you would do it anyway just for the current benefit.



Conservation Practices - Expenses or Assets

If it is an asset:

- In the year you receive the payment, taxable income exceeds the related depreciation deduction.
- In later years, you claim depreciation deductions without corresponding income.



Conservation Practices that are Annual Expenses

Conservation practices that are part of your normal annual farming practices are usually deducted as ordinary and necessary business expenses if they are part of how you:

- Increase annual soil fertility
- Manage weeds and pests
- Improve the quality of your product
- Provide pasture or forage



Conservation Expenditures for Assets

Conservation funds used to create assets that are a key part of your normal farming operation and also a key part of a conservation strategy are treated like any other farm asset.

- Cross fencing
- Livestock ponds
- Trees to shade and shelter livestock



Conservation Expenditures for Assets

You buy or build a hoop house and use it in your normal operations.

Capitalize the cost (that means treat the hoop house as an asset) and take a depreciation deduction according to the usual rules for asset depreciation.



Conservation Expenditures for Assets

You cross-fence your property to improve pasture-management.

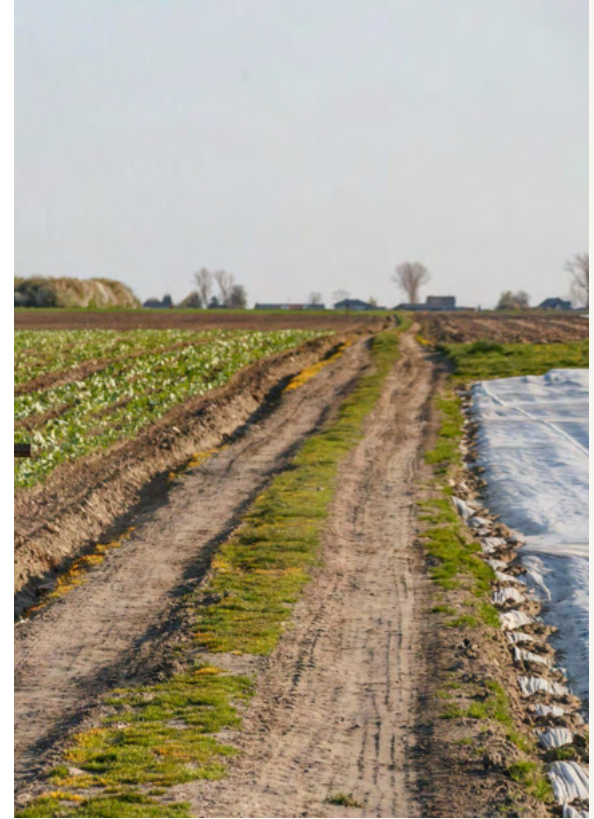
Capitalize the cost (that means treat the fence as an asset) and take a depreciation deduction according to the usual rules for asset depreciation.



Conservation Expenditures not Directly Tied to Production

A third type of conservation expenditures are those that are **not directly related to producing crops or livestock**. These include:

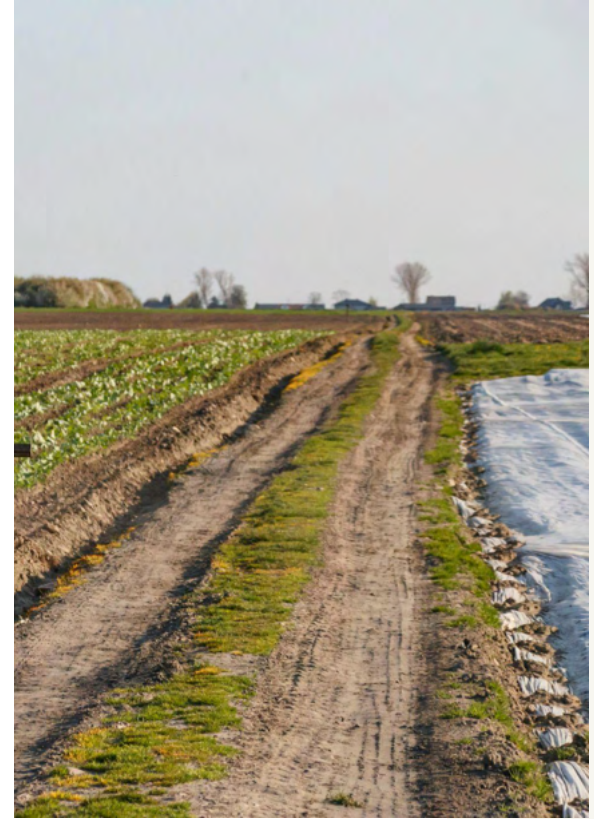
- Soil conservation projects such as grading or terracing, if they do not increase yields
- Projects to create or enhance habitat, such as planting trees or hedgerows for wildlife habitat, or fencing off natural waterways



Conservation Expenditures Not Directly Tied to Production

Taxpayers may elect to deduct as long as:

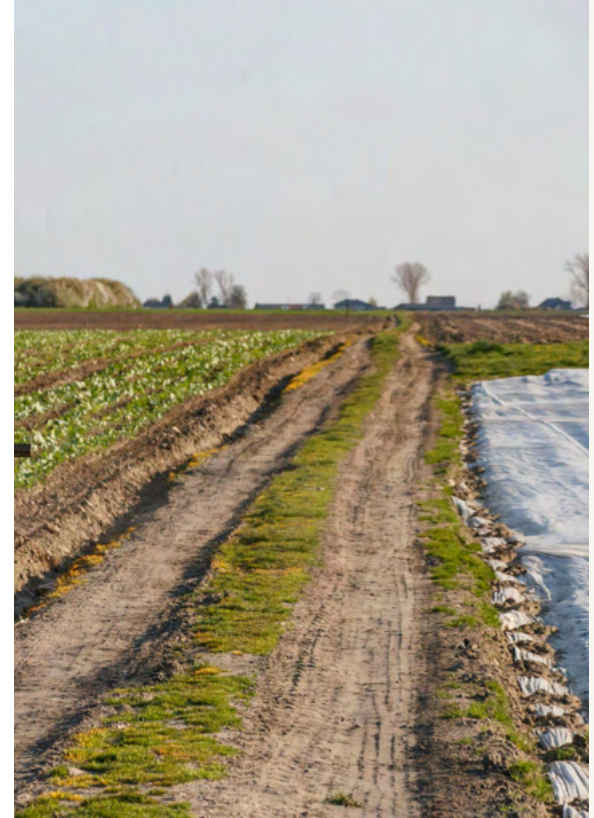
1. The land is used and was previously used in the business of farming or ranching.
2. Expenditures are to implement a plan approved by the USDA Natural Resources Conservation Service



Conservation Expenditures Not Directly Tied to Production

If the taxpayer makes this election:

- The deduction for each year is limited to 25% of gross income from farming and ranching for that year.
- The excess may be carried forward for future tax years until fully deducted.



Summary

Any income you receive is reported as business income. Associated project costs are reported as:

1. Ordinary and necessary business expenses (deduct in current year).
2. Depreciable assets used in the ordinary course of business (capitalize and depreciate).
3. Special election for NRCS project assets for conservation projects not directly tied to annual production practices (deduction limited to 25% of gross farm income each year - may carryforward till fully deducted).



Insurance and Other Income



Insurance and Other Relief Income

Types of income included in farming or ranching:

- Federal crop insurance for lost crops or livestock (obtained from private insurance companies but subsidized by USDA RMA)
- Non-insured Crop Disaster Assistance (inexplicably called NAP and paid by the FSA)
- Other government disaster relief payments
- Other private insurance payments
- State, local and private grants and awards



Income Deferral Election

A taxpayer may elect not to be taxed on crop insurance or disaster relief payments in the year received. Instead, the payment can be deferred to the following year.



Special Rules for Livestock

See FarmLink Tax Toolshed Lesson 6.6.a



Additional Resources



Additional Resources

1. [IRS Publication 225 - The Farmer's Tax Guide](#) readable and comprehensive tax guide
2. [RuralTax.org](#) additional topics, beginning and intermediate
3. [Center for Agricultural Law and Taxation at Iowa State](#) advanced topics
4. [California FarmLink's Tax Toolshed](#) - introductory presentations and recordings
5. [Agricultural Finance, Tax and Asset Protection Program from the Southern Extension Risk Management Education Center](#) many topics, all levels



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Questions?





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