Crop Insurance Audits
By: Suzy Martin

Crop insurance auditors will certainly be busy in the upcoming months. Fortunately for both auditors and producers the automatic audit limits have increased from $100,000 to $200,000 per crop per county. If a producer receives more than $200,000 in claims, they can expect to have to prove their Actual Production History (APH) for the past three years. In other words, the farmers must have evidence to support the production that was certified in 2009-2011. If you expect to exceed this limit it might be prudent to start working on organizing your records. Check with your crop insurance agent about the specifics for your operation, but supporting documents can be anything from settlement sheets, scale/load tickets, feed records, yield monitor reports, Kentucky Farm Business Management records or some combination thereof.

Tax Update and Implications for 2012
By: Rush Midkiff

There are two big tax code changes for business owners this year. First in 2011, I.R.C. Section 179 (accelerated depreciation) was a maximum of $500,000 or taxable income from all trades or businesses (including wages). The investment limit for beginning the phase-out of the deduction was $2,000,000. As of the writing of this article, the 2012 I.R.C. Section 179 deduction is a maximum $139,000 or the taxable income from all trades or businesses (including wages). The investment limit for beginning the phase-out of the deduction is $560,000.
The second big change is in bonus depreciation. In 2011, taxpayers could take a 100 percent deduction on all qualified brand new equipment and building purchases with a MACRS life of 20 years or less. In 2012, the deduction is 50 percent for qualified new equipment and building purchases with a MACRS life of 20 years or less.

There have been very few other changes to the tax code this year. Maximum capital gains are still 15%. The income rates have remained unchanged although the brackets have been adjusted for inflation. However, in 2013 the Bush tax cuts will be expiring and the implications of the Affordable Care Act (Health Care Act) will go into effect. It is expected that there will be many changes to our tax code after this election.

Many farmers carried a record large crop into the 2012 tax year. To compound the problem, a lot of farmers are likely to receive significant crop insurance payments for their 2012 crop losses. Specialists are starting their fall visits this month and it is advised that all KFBM cooperators take a hard look at their tax position to avoid any surprises come tax time.

**Tax Implications of Drought**

By: Lauren Omer

Farmers across the state of Kentucky have been faced with drought conditions this summer. Based on this year's drought, there will most likely be large crop insurance claims. Livestock producers are struggling to find adequate feed supplies, which could result in selling more livestock than normal. In both situations, farm income could be higher than normal, despite the weather disaster. With proper planning, producers may be able to structure when to report these crop insurance proceeds and/or additional livestock sales in order to achieve the best tax advantage.

Many producers carried large grain inventories into 2012 and have already received considerable income from grain sales this year. As a result, these producers might not want to pay taxes on the crop insurance income in 2012. Crop insurance proceeds due to crop damage must be reported in the year of receipt. However, the tax laws do allow farmers to make a deferral on income taxes until the next year if certain conditions are met. Farmers can postpone reporting crop insurance proceeds as income until the year following the year the damage occurred if the cash method of accounting is used, the crop insurance proceeds are received in the same year the crops were damaged, and it can be shown that under normal business practices the income from the damaged crops would have been included in the tax year following the year the damage occurred. Only the payment for destruction or damage to the crop (yield loss) is eligible for deferral. Indemnities from price declines are not deferrable. If it is not itemized from the insurance company, the company must be contacted to determine what part of the indemnity is from a price decline and what part is from a yield loss.

For example: Farmer John uses the cash method of accounting. He receives a claim for damage done to the 2012 crop in November 2012. The claim is for damage done to the crop, not a reduction in price. In a normal business year, Farmer John sells only 25% of his grain in the year it is harvested and carries 75% of it into the following year. Farmer John would be able to defer the tax liability of the crop insurance proceeds to 2013.

Generally if producers elect to defer any eligible crop insurance proceeds, all such crop insurance proceeds must be deferred, including federal crop disaster payments. If payments are received for multiple crops, the payment for one crop cannot be postponed unless the payments for all crops are postponed. Also, the sales from the crops that are normally postponed must be more than 50% of the total sales in order to defer the proceeds. The election to defer is made on the tax return. The amount of crop insurance proceeds received is reported on Schedule F, line 6a. However, if it is being deferred, do not include it as a taxable amount on line 6b. A statement must also be attached to the tax return that includes the specific crop or crops damaged; a declaration that under normal business practices, the crop sales would have been included in income in the following
year; the cause of the destruction or damage and the dates it occurred; the total payments you received, itemized for each specific crop, and the date you received payment; and the name of the insurance carrier.

For livestock producers, a livestock deferral can be made for those who were forced to sell livestock because of a weather-related disaster. In order to postpone reporting the gain from the additional animals until the next year, the principal business must be farming, the cash method of accounting must be used, it can be proven that under normal business practices the additional animals would not have been sold, and the weather-related condition must have caused the area to be designated as eligible for assistance by the federal government. Sales made before an area became eligible for federal assistance do qualify if the animals were sold as a result of the same weather-related condition that caused the area to be designated as eligible for assistance. Only the gain on the sale of those animals above and beyond what was normally sold, qualify for postponement.

For example: Farmer John uses cash basis accounting and normally sells 100 head of cattle a year. As a result of drought, he sold 150 head during 2012. Sales totaled $114,000. In July 2012, as a result of drought, the area was declared a disaster area eligible for federal assistance. The income that can be postponed until 2013 is $38,000 [(114,000/150) * 50]. Income from livestock held for draft, breeding, or dairy purposes is not taxed if like-kind animals are repurchased within four years from the end of the tax year in which the animals were sold.

Weather variability is one of the main risks in agricultural production. This variability has an impact on crop and livestock production and thus farm income. It is important for all producers to analyze their situation and determine how income should be treated. Tax planning will be essential this year, as noted above, the Section 179 limit is currently set at $139,000 and bonus depreciation is limited to 50% on new assets. Before making any large income/expense decisions, please consult with your tax professional or KFBM specialist.

Sales Tax Status on Header Wagons and Lawn Mowers
By: Michael Forsythe

Many of you have purchased header wagons in recent years in Kentucky and have had to pay sales tax because it was classified as a “trailer”. The Kentucky Department of Revenue previously determined that a “trailer” was not a farm wagon; therefore, it was subject to sales and use tax.

Earlier this year, the department reversed their stance on this issue and determined that header wagons are eligible for the farm machinery exemption according to KRS 139.480. If you were previously required to pay sales and use tax on a header wagon purchase, you may be eligible for a refund on the tax paid. A full refund can be claimed up to four years back from when the sales tax was paid to the Department. For any information about the refund process, contact the Kentucky Department of Revenue, Sales and Use Tax Division, at (502)564-4581.

In another note, many farmers have bought lawn mowers to use on the farm and they have had to pay sales tax on the purchase of the lawn mower. Lawn mowers do not meet the requirements for the farm machinery exemption in KRS 139.480, so they are subject to sales and use tax.

Welcome Laura Powers

In mid-September, Laura Powers became the newest Farm Analysis Specialist, serving the Pennyroyal Farm Analysis Group. Laura spent the previous five years as an Extension Specialist with the University of Kentucky, Department of Agricultural Economics, working in tobacco financial analysis and labor education. She has both a Bachelor’s and Master’s Degree in Agricultural Economics from UK. Previous work experience also includes time as a Credit Analyst with CoBank and a Business Development Specialist with the Kentucky Center for...
Agricultural and Rural Development. Laura brings over 14 years of farm and financial management experience to the Kentucky Farm Business Management Program.

Specialist Transfer

Amanda has transferred from the Lincoln Trail Farm Analysis Group to the Pennyroyal Farm Analysis Group. Her transfer date was September 1st, 2012.

Farewell Evan Conrad

Evan Conrad, a specialist in the Pennyroyal Farm Analysis Group, resigned in September. He has taken a position with Agri-Chem in Hopkinsville, Kentucky. We wish him the best in his new endeavor.

Upcoming KFBM Events:

Nov. 15th – Planning for the Next Generation of Your Farm Family, Gilbertsville, KY
Nov. 16th – Planning for the Next Generation of Your Farm Family, Hopkinsville, KY
Nov. 20th – Purchase Farm Analysis Group Annual Meeting
Nov. 26th – Pennyroyal Farm Analysis Group Annual Meeting
Nov. 27th – Ohio Valley Farm Analysis Group Annual Meeting
Dec. 4th – State Association Board of Director’s Meeting - Lexington

Please start gathering information and preparing for Check-In.