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HANDLING RAIN AND FLOOD DAMAGE

— by Neil E. Harl*

Heavy rains and widespread flooding in the Upper Midwest have focused attention on financial and tax relief provisions available to farmers and those involved in agribusiness in the region. While some tax enactments are limited to drought,¹ others are applicable to flooding and excessive rainfall.²

Crop insurance and disaster assistance. As a general rule, proceeds from insurance such as from hail coverage on growing crops are includible in gross income in the year actually or constructively received.³ Farmers on the cash method of accounting may be eligible to defer income from crop insurance and federal disaster payments until the following year.⁴ If, under the taxpayer's method of accounting, income from sale of the crop would have been reported in the following year, income from the crop in the form of crop insurance proceeds or federal disaster payments may be reported in the taxable year following the year of crop loss.⁵ Crop insurance and disaster payments must be treated the same if received in the same taxable year.⁶ Regulations which became final in 1992 permit deferral⁷ even though the statute limits deferral for federal assistance to payments under the Agricultural Act of 1949 or title II of the Disaster Assistance Act of 1988.⁸

Under the deferral rules, insurance proceeds from "destruction of, or damage to, crops" are eligible for the one-year deferral.⁹ Federal payments received as a result of "destruction or damage to crops caused by drought, flood, or any other natural disaster, or the inability to plant crops because of such a natural disaster" are treated as insurance proceeds for this purpose.¹⁰

If the taxpayer establishes that a substantial part of the crops would have been reported in the following year, the taxpayer is eligible to defer but cannot defer only a portion to the following year.¹¹ The election is made by attaching a separate, signed statement to the income tax return for the tax year of damage or destruction or an amended return.¹²

Deferral of income from livestock. Farm and ranch taxpayers on the cash method of accounting who are forced because of drought to dispose of livestock are eligible to defer reporting the gain to the following year.¹³ Legislation has been introduced that would extend the same treatment to

livestock sold because of hurricane, tornado or flooding but that legislation has not been enacted into law.¹⁴

Reinvestment of livestock sales. If a farmer sells livestock (other than poultry) held for draft, dairy or breeding purposes in excess of the number that would normally be sold during that time period, the sale or exchange of the excess number is treated as an involuntary conversion *if the sale occurs solely* on account of drought.¹⁵ Of course, actual casualty loss of property may be treated as an involuntary conversion.

Federal feed assistance. Special rules apply to benefits received under the Emergency Livestock Feed Assistance Program but those provisions apply only to feed expenditures *incurred as a result of drought*.¹⁶

Casualty losses. Losses arising from "fire, flood, storm, shipwreck and other similar casualties"¹⁷ are deductible as casualty losses. Casualty losses have been allowed for flood damage to trees and vegetables,¹⁸ mud slides¹⁹ and for losses from rainstorms which caused damage to a dam.²⁰ However, the loss deduction is limited to the area flooded and a deduction is not allowed for loss of anticipated profits or reduction in asset value for the rest of the property.²¹

Casualty losses are generally the difference in fair market value of the property before and after the loss but in no event can the deduction exceed the income tax basis of the property.²² Insurance received must be used to reduce the deduction. For nonbusiness casualty losses, the first \$100 of loss is not deductible and the loss must exceed 10 percent of the taxpayer's adjusted gross income. Neither the \$100 floor nor the 10 percent of AGI limit applies to losses of business or investment property.

The cost of repairs to restore property to its original condition may be an acceptable indicator of value if the amount spent on repairs is not excessive and the value of the property after repairs does not exceed its value before the casualty.²³

When to deduct. Ordinarily, losses are claimed in the year the loss is sustained.²⁴ However, if the President has declared that the area warrants federal assistance, the taxpayer may elect to treat the loss as sustained in the immediately preceding year.²⁵

If a principal residence is damaged or destroyed by fire, storm or other casualty, amounts received from insurance are not included in gross income if used to compensate or reimburse for loss of use or occupancy of the residence by the taxpayer and members of the household.²⁶ The amount

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excludible is the excess of actual over normal living expenses.²⁷ The amount of insurance proceeds excludible from income cannot be determined until the end of the loss period, with any excess includible in income for the taxable year in which the loss period ends or, if later, the year the excess is received.²⁸

SPECIAL NOTE: The IRS has announced that in flooded areas of the midwest returns due on or after June 30, 1993 may be filed without penalty by October 15, 1993. Interest, however, will be due for the period of the delay. Taxpayers should write in red "FLOOD DISASTER, COUNTY OF ____" on the top of their returns. **IR 93-62, July 27, 1993.**

Also, the Revenue Reconciliation Act of 1993 includes relief provisions involving losses relating to flooding. See p. 126-127 *supra*.

FOOTNOTES

- ¹ E.g., I.R.C. § 1033(e) (sale and reinvestment of livestock held for draft, dairy or breeding purposes).
- ² E.g., I.R.C. § 451(d) (one-year deferral for crop insurance proceeds and federal disaster assistance payments).
- ³ Treas. Reg. § 1.61-4(c).
- ⁴ I.R.C. § 451(d). See generally 4 Harl, *Agricultural Law* § 27.03[7][a] (1993); Harl, *Agricultural Law Manual* § 4.02[4] (1993).
- ⁵ I.R.C. § 451(d). See Rev. Rul. 91-55, 1991-2 C.B. 784.

- ⁶ Notice 89-55, 1989-1 C.B. 696.
- ⁷ Treas. Reg. § 1.451-6.
- ⁸ I.R.C. § 451(d).
- ⁹ Treas. Reg. § 1.451-6(a)(1).
- ¹⁰ *Id.*
- ¹¹ Rev. Rul. 74-145, 1974-1 C.B. 113. See Notice 89-55, 1989-1 C.B. 696.
- ¹² Treas. Reg. § 1.451-6(b).
- ¹³ I.R.C. § 451(e).
- ¹⁴ H.R. 2735, 102d Cong., 2d Sess. (1992).
- ¹⁵ I.R.C. § 1033(e).
- ¹⁶ See Rev. Rul. 79-263, 1979-2 C.B. 82; Notice 89-55, 1989-1 C.B. 696.
- ¹⁷ I.R.C. § 165. See Treas. Reg. § 1.165-7(a)(1).
- ¹⁸ *Maduz v. Comm'r*, T.C. Memo. 1961-249.
- ¹⁹ *Radding v. Comm'r*, T.C. Memo. 1988-250 (deduction limited to repair costs in excess of insurance recovery).
- ²⁰ *Helstoski v. Comm'r*, T.C. Memo. 1990-382.
- ²¹ *Id.* See *Beyer v. Comm'r*, T.C. Memo. 1993-313 (deduction allowed for repairs because of storm damage; deduction not allowed for diminution in value of beach front property).
- ²² I.R.C. § 165(a), (b).
- ²³ Treas. Reg. § 1.165-7(a)(2).
- ²⁴ See I.R.C. § 165(a).
- ²⁵ Treas. Reg. § 1.165-11(a), (b).
- ²⁶ I.R.C. § 123(A).
- ²⁷ I.R.C. § 123(b).
- ²⁸ Rev. Rul. 93-43, I.R.B. 1993-24, 54.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

FENCES-ALM § 1.01[2].* The plaintiff was injured when the plaintiff's truck struck a horse owned by the defendant on an interstate highway. The highway was in a "horse herd district" and the state highway department had constructed a fence between the highway right-of-way and the defendant's land. The state was named as a defendant for negligently failing to maintain the fence. The court held that the state had no duty to maintain the fence under statute or regulations and therefore could not be held liable for negligent maintenance of the fence. **Yager v. Deane, 853 P.2d 1214 (Mont. 1993).**

BANKRUPTCY

GENERAL

EXEMPTIONS

AVOIDABLE LIENS. The debtors had claimed a rural homestead as exempt in a Chapter 7 case. Prior to the bankruptcy filing, a creditor obtained a judgment lien against the debtors' property. The debtors were denied a discharge under Section 727 and filed for avoidance of the judgment lien as impairing their homestead exemption. The court held that the denial of discharge did not affect the avoidance rights of the debtors for liens which impaired exemptions. The court also held that the judgment lien was not avoidable for impairing the homestead exemption because, under Texas law, judgment liens do not attach to property previously declared to be the debtor's homestead;

therefore, the lien could not impair the homestead exemption. ***In re Henderson, 155 B.R. 157 (Bankr. W.D. Tex. 1992).***

The debtors owned two properties, a residence and a gas station. The properties were subject to the same wrap-around mortgage and had a fair market value of \$11,000 more than the remaining amount on the mortgage. The debtors claimed the entire equity amount as exempt. The properties were also subject to a judicial lien for \$10,000. The court held that because the properties were both subject to the same indebtedness, the two properties would be combined for purposes of determining whether the debtors had any equity in the properties. The court held that the judicial lien would be avoided as impairing the debtors' equity in the properties. An unexplained issue in the case is what exemption was claimed as to the gas station property. The debtors had claimed only a homestead exemption under Section 522(d)(1) and the court did not discuss the availability of that exemption for the gas station. A better result would have been reached had the total equity been allocated to the separate properties, based on relative fair market values, and the judicial lien avoided to the extent it impaired the allowable homestead exemption on the residence. ***In re Frameli, 155 B.R. 354 (Bankr. W.D. Pa. 1993).***

The debtor owned property with the nondebtor spouse as tenants by the entirety and claimed an exemption in the property to the extent of the debtor's right to use and control the property, the exemption allowed under Tennessee law.