Choosing crop insurance units in 2011

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Crop producers have several choices for combining different tracts of land when purchasing crop insurance. Each combination of tracts that is insured independently of other combinations is called a unit. One particular farming operation may have one unit or multiple units. Units can be designated as optional, basic, enterprise or whole farm. The choice will affect the premiums paid each year, as well as the size and likelihood of any indemnity payments received.

Optional units
Farms that are owned or cash rented by the operator, and are located in different township sections, can be insured individually in optional units. The guarantees, premiums, production and potential indemnity payments are calculated separately for each optional unit. Likewise, a separate production history is needed to establish the actual production history (APH) yield. Optional units give the most protection against isolated weather losses such as hail or wind, but also have the highest premiums. Optional units can also be created when the same crop is being grown under distinctly different farming practices, such as irrigated and dryland corn.

Basic units
Producers can combine all the land they own or cash in rent in different sections in the same crop into one basic insurance unit. All the acres of each crop are considered together when establishing guarantees and payments. Farms rented under a crop share lease, however, must each be in a separate basic unit. The crop share landowner can also insure his or her interest in the crop as a separate basic unit. Basic units receive a premium discount compared to optional units.

Enterprise units
An enterprise unit combines all acres of a single crop within a county in which a policyholder has an interest into a single unit, regardless of whether they are owned or rented, or how many landlords are involved. The insured crop must be grown in two or more township sections within the county. Under the new common crop insurance policy rules, at least two of the sections must contain 20 acres or more.

Handbook updates
For those of you subscribing to the handbook, the following updates are included.

Managing Risk with Crop Insurance – A1-48 (4 pages)
Important Crop Insurance Dates – A1-50 (2 pages)
Yield Protection Crop Insurance – A1-52 (2 pages)
Revenue Protection Crop Insurance – A1-54 (4 pages)
Proven Yields and Insurance Units for Crop Insurance – A1-55 (4 pages)

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of the crop. Or, if the unit contains less than 100 total acres, then at least two sections must contain 20 percent or more of the total acres. For example, a farmer who insured 40 acres in one section would have to combine them with at least 10 acres in another section in the same county to qualify for an enterprise unit.

**Whole farm units**
Growers who are willing to combine all their insured crops into a single insurance unit can gain additional premium discounts. This is called a whole farm unit. The amount of the discount will depend on the proportion of the total acres planted to each crop. Whole farm units are available for Revenue Protection insurance, but not for Yield Protection policies.

In general, the more tracts of land that are combined into a single insurance unit, the less likely it is that a yield loss on just one tract will trigger an indemnity payment. This is particularly true if the tracts are dispersed throughout the county. One tract may get hailed out, but that production loss can be offset by average or better yields on another tract. For that reason, producers who purchase enterprise or whole farm units should consider also purchasing add-on insurance for isolated losses from hail, wind and/or fire.

On the other hand, if a producer is primarily concerned about declining market prices, any unit structure under a Revenue Protection policy gives the same price risk protection. This is because the same prices used to set the level of guarantee and the actual revenue each year are applied to all insured acres, regardless of the size, number or location of the units. Thus, aggregating land into larger insurance units does not diminish price risk protection. Given the current high levels of futures prices for corn and soybeans, the chances of lower prices occurring by harvest may be greater than usual in 2011.

**Premises lower**
Perhaps most important, aggregating acres into larger units will result in lower overall insurance premiums. Table 1 shows an example of typical farmer premiums for corn, for land in Story County, Iowa, under different unit structures. The discount for enterprise units arises because the overall production risk is reduced by including more acres in a policy, and because the percent premium subsidy from the Risk Management Agency is higher. Many producers who have moved from basic to enterprise units have opted to increase their coverage levels, which provides a higher overall revenue guarantee for the same or less cost.

Enterprise units will probably result in less frequent, but larger, indemnity payments compared to basic units. Once the crop is harvested, however, the bushels are generally commingled before they are marketed, and the dollars received from the sale of the crop will go into the same bank account. Thus, guaranteeing a minimum revenue for all the combined farm acres is consistent with the overall financial management of the business.

More information on crop insurance is available on the AgDM website under Crops - Cost & Return.

### Table 1. Typical premiums, Story County per ac.*

<table>
<thead>
<tr>
<th>Coverage Level</th>
<th>Corn, Basic Units</th>
<th>Corn, Enterprise Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td>$5.84</td>
<td>$2.52</td>
</tr>
<tr>
<td>65%</td>
<td>$10.30</td>
<td>$3.20</td>
</tr>
<tr>
<td>70%</td>
<td>$15.36</td>
<td>$4.72</td>
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<tr>
<td>75%</td>
<td>$23.77</td>
<td>$7.28</td>
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<td>80%</td>
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<tr>
<td>85%</td>
<td>$57.49</td>
<td>$24.91</td>
</tr>
</tbody>
</table>

*Example only. Actual premiums will differ.
The highly controversial Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, hereinafter referred to as the Tax Relief Act, which involved major political compromises, was signed into law on Dec. 17, 2010. Although the legislation is only 33 pages in length, the budget implications are substantial and the provisions far-reaching. A brief summary of the more important provisions to the agricultural sector is provided here. A more detailed discussion of the provisions which were extended is published in volumes 4-8 of Agricultural Law and volumes 1 and 2 of Farm Income Tax Manual.

Federal estate, gift and generation-skipping tax provisions

Federal estate tax for 2011 and 2012
As is widely known, the federal estate tax was repealed in 2001 effective for deaths after Dec. 31, 2010, for a one-year period, at a time when the applicable credit amount was set at $3.5 million and the maximum rate was 45 percent. However, the tax was scheduled to re-emerge Jan. 1, 2011 with an applicable credit amount of $1 million and a maximum rate of 55 percent.

The Tax Relief Act approved an applicable credit amount (which equals the applicable exclusion amount) of $5 million for 2011 and 2012 (with inflation adjustment for 2012) and a maximum estate tax rate of 35 percent.

The 2010 Act enables the surviving spouse to utilize the remaining applicable credit (or applicable exclusion amount) of the last deceased spouse (dying after 2010) of the surviving spouse. That could mean up to a $10 million applicable credit amount for the surviving spouse (if the last deceased spouse used none of the applicable credit amount available to that individual). The executor must elect and the election must be on a timely-filed federal estate tax return.

Election and basis determination for deaths in 2010
The Tax Relief Act did not make the 2010 enactment retroactive to cover deaths in 2010, as had been widely discussed, but the Tax Relief Act did authorize an election for deaths in 2010 relative to income tax basis determination. Under that provision, for decedents dying in 2010, the executor of the estate can elect (for property acquired or passing from a decedent within the meaning of I.R.C. § 1014(b) –
(1) to apply the estate tax rate and applicable credit amount for 2011 with a new basis at death (stepped up or down, as the case may be) or
(2) to apply the estate tax rules for 2010 (no tax) and use the modified carryover basis rules applicable to deaths in 2010.

For deaths in 2010, the dates returns are due, the dates payments of tax are due and the dates making disclaimers by reason of death are set not earlier than nine months from the date of enactment (Dec. 17, 2010).

The income tax basis for property passing at the death of a decedent in 2010 is set at death in 2010, not in some later year when the property is sold as some have argued.

Federal gift tax for 2011 and 2012
The Tax Relief Act reunites the federal estate and gift tax, beginning in 2011. Therefore, the $1 million applicable exclusion amount for federal gift tax is no longer available after 2010 and gifts beyond the annual exclusion, charitable deduction, transfers for educational expenses and medical expenses, and loans of artworks are subtracted from the $5 million applicable credit amount for estate and gift tax purposes.

Generation-skipping tax for 2011 and 2012
The Tax Relief Act reinstates the generation-skipping transfer tax and provides for a $5 million exemption for 2010 and later years which equals the applicable credit for estate tax purposes with a tax rate of zero percent for 2010. The zero rate for 2010 transactions suggests that the generation-skipping tax was in effect for 2010, notwithstanding the language in the legislation repealing (and reinstating) federal estate tax and generation-skipping transfer tax. The Economic Growth and Tax Relief Reconciliation Act of 2001 states –

“This chapter [Chapter 13, Generation-Skipping Transfers] shall not apply to generation-skipping transfers after December 31, 2009.”

The same legislation states, in Section 901(a)(2) –

“All provisions of, and amendments made by, this Act shall not apply -- . . . estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010.”

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Thus, a reasonable conclusion could be reached that the generation skipping transfer tax was repealed for the year 2010.

The conclusion that the drafters believe that the generation skipping transfer tax was retroactively reenacted effective in 2010 is buttressed by Section 301(d)(2) of the Tax Relief Act which states –

“GENERATION-SKIPPING TAX. -- In the case of any generation-skipping transfer made after December 31, 2009, and before the date for filing any return under section 2662 of the Internal Revenue Code of 1986 (including any election required to be made on such a return) shall not be earlier than the date which is 9 months after the date of the enactment of this Act.”

Moreover, Sections 301(a) of the Tax Relief Act provides as follows –

“(a) IN GENERAL. – Each provision of law amended by subtitle A or E of title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 is amended to read as such provision would read if such subtitle had never been enacted.”

At stake is the tax liability in later years (after 2010) for distributions from GST transfers in 2010. The issue of constitutionality for a retroactive enactment may be raised of a tax provision on which taxpayers had planned and executed transfers in reliance on the repeal language believed to be effective in 2010.

The GST rate equals the highest estate and gift tax rate for 2011 and 2012 (35 percent).

Changes in depreciation

Expense method depreciation
The Small Business Jobs Act of 2010 increased the expense method depreciation allowance to $500,000 (with no inflation adjustment) with an investment limit phase-out of $2 million for tax years beginning in 2010 and 2011. The Tax Relief Act provides for a $125,000 limit (indexed for inflation) for tax years beginning in 2012 (with a phase-out of $500,000) and $25,000 after 2012 (with a phase-out of $200,000).

Computer software eligibility for expense method depreciation is extended through 2012. To be eligible, the software must be Section 1245 property and be acquired for use in a trade or business.

Bonus depreciation

Depreciable real estate – 15-year property
The Tax Relief Act specifies that qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements are 15-year property if placed in service before Jan. 1, 2012.

Other provisions

Payroll tax reduction
The Tax Relief Act reduces the employee share of the OASDI portion of social security taxes from 6.2 percent to 4.2 percent. That is for wages earned in calendar year 2011 and is up to the taxable wage base of $106,800. For self-employed individuals, the reduced rate is 10.4 percent on self-employment income up to the threshold of $106,800.

Alternative minimum tax
For 2010, the Tax Relief Act increases the AMT exemption amount to $47,450 for individual taxpayers, $72,450 for married taxpayers filing jointly and surviving spouses and $36,225 for married couples filing separately. For 2011, the figures are $48,450, $74,450 and $37,225, respectively.

Capital gains and dividends
The Tax Relief Act continues for two years the rates in effect for 2010 (a maximum rate of 15 percent and zero percent for taxpayers in the 10 and 15 percent tax brackets). The Act also extends for one year, through 2011, the 100 percent exclusion of gain from qualified small business stock held for more than five years for stock acquired after Dec. 31, 2010.

Tax-free distributions from individual retirement plans for charitable purposes
The Tax Relief Act extended the tax-free distributions of up to $100,000 from individual retirement accounts by individuals age 70 ½ or older without triggering income and without taking a charitable deduction through 2011. A taxpayer can elect for qualified distributions after Dec. 31, 2010 and before Feb. 1, 2011 to be deemed to be 2010 distributions.
Contributions of real property for conservation purposes
The Act extends the deduction for “qualified conservation contributions” for two additional years, through 2011 and extends the rule for qualified farmers and ranchers for two more years, also.

Expensing of environmental remediation costs
The Tax Relief Act extended the election to treat “qualified environmental remediation expenditures” as currently deductible, through 2011.

Work Opportunity Credit
The Act extends, through Dec. 31, 2011, for those who begin work for the employer after the date of enactment of the Act (Dec. 17, 2010), the Work Opportunity Tax Credit. However, the Act did not extend the authority for the two categories of target groups which were added in 2009, unemployed veterans and disconnected youth (ages 16 through 24). I.R.C. § 51(d)(14) authorized the credit for the two categories of targeted groups added in 2009.

Incentives for biodiesel and renewable diesel
Credits for biodiesel and renewable diesel used as fuel were extended through 2011. The excise tax credits and outlay payments for biodiesel and renewable diesel fuel mixtures were also extended through 2011 with a procedure for allowing payments for 2010.

Extension of provisions for alcohol used as fuel
The Act extends the income tax credit for alcohol used as fuel, the reduced amount for ethanol blenders, the excise tax for alcohol used as fuel, the payment for alcohol fuel mixtures and the extension of additional duties on ethanol, for one year, through 2011.

Enhanced charitable deduction for food inventory
The Tax Relief Act extends the enhanced charitable deduction for food inventory through 2011.

Itemized deduction limitation
The Act continues the repeal of the limitation on itemized deductions which was in effect in 2010 for two additional years, through Dec. 31, 2012. This is important for high income taxpayers and encourages charitable giving, among other itemized deductions.

Personal exemption phase-out
The Tax Relief Act also extends repeal of the personal exemption phase-out for two years, through 2012.

Basis adjustment of stock of S corporations for charitable contributions
The reduction in stock basis in an S corporation equal to the shareholder’s pro rata share of the adjusted basis of property contributed to a charitable organization is continued for two more years, through 2011.

Energy provisions
The Tax Relief Act contains several provisions which have provided energy tax incentives and those are continued for one or two years including the non-business energy property credit under I.R.C. § 25C with modifications, including a return to pre-ARRA standards; a new energy efficient home credit for qualified builders and manufacturers (for homes purchased before 2012); and the energy efficient appliance credit. The latter includes credits, applicable to appliances produced after Dec. 31, 2010, for $25, $50 and $75 on dishwashers, based on kilowatt usage; a credit for clothes washers of $175 and $225 based on energy and water consumption; and a credit for $150 and $200 for refrigerators based on rated energy usage.

Other provisions
The Act extends, for two years, the child tax credit; the earned income tax credit; the American Opportunity Tax Credit; state and local sales tax deduction; higher education tuition deduction; and the teachers’ classroom expense deduction. The Act also extends the adoption credit, the dependent care credit, employer-provided child care credit, the educational assistance exclusion, the student loan interest deduction and the Coverdell education savings account contributions, all under the general continuation provisions of the Act.

Updates, continued from page 1

Delayed and Prevented Planting Provisions – A1-57 (4 page)
Group Risk Plan (GRP) and Group Risk Income Protection (GRIP) – A1-58 (2 pages)
Cash Corn and Soybean Prices – A2-11 (4 pages)
Please add these files to your handbook and remove the out-of-date material.

Internet Updates
The following updates have been added on www.extension.iastate.edu/agdm.

Checklist for Iowa Agricultural Employers – C6-58 (2 pages)

Decision Tools and Current Profitability
The following tools have been added or updated on www.extension.iastate.edu/agdm.

Corn Profitability – A1-85
Soybean Profitability – A1-86
Ethanol Profitability – D1-10
Biodiesel Profitability – D1-15
Returns for Farrow-to-Finish – B1-30
Returns for Weaned Pigs – B1-33
Returns for Steer Calves – B1-35
Returns for Yearling Steers – B1-35