



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

February 22, 2002

Number: **200213026**
Release Date: 3/29/2002
PREF-110250-02/CC:IT&A:B3
UILC: 451.23-00; 1301.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE TECHNICAL ASSISTANCE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL,
SMALL BUSINESS/SELF-EMPLOYED
CC:SB:7:POR:1

FROM: Associate Chief Counsel
(Income Tax and Accounting)

SUBJECT: Klamath Basin Payments
PREF-110250-02

This Chief Counsel Advice provides a response to a request for advice that originated from a matter described in an e-mail dated January 16, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

1. Whether certain taxpayers can elect under § 451(d) of the Internal Revenue Code to defer payments they received during 2001 pursuant to section 2104 of the Supplemental Appropriations Act, 2001 (Pub. L. No. 107-20, 115 Stat. 155 (2001)) (the Act).
2. Whether individuals engaged in a farming business who can elect to average farm income under § 1301 of the Code may treat payments received under section 2104 of the Act (section 2104 payments) as income attributable to a farming business for purposes of determining the amount of taxable income that is attributable to a farming business under § 1301(b)(1)(A)(i).

CONCLUSIONS

1. Taxpayers whose crops were destroyed or damaged during 2001, or who were unable to plant crops in 2001, and who report on the cash receipts and disbursements method of accounting may elect to include section 2104 payments in income for 2002 if they can establish that, under their practice, income from

irrigated crops that would have been grown during 2001 would be reported in a following taxable year.

2. Individuals engaged in a farming business may treat section 2104 payments as income attributable to a farming business for purposes of determining the amount of taxable income that is attributable to a farming business under § 1301(b)(1)(A)(i).

FACTS

Section 2104 of the Act provides \$20,000,000 from amounts available to the U.S. Department of Agriculture's Commodity Credit Corporation under 15 U.S.C. § 713a-4 for the Secretary of Agriculture to provide financial assistance to eligible agricultural producers in the Klamath Basin, which is located in the high-desert inter-mountain region of Klamath County, Oregon, and Siskiyou and Modoc Counties, California.

The agricultural producers in the Klamath Basin traditionally received deliveries of irrigated water. During 2000-2001, the Klamath Basin was adversely impacted by record low levels of precipitation, stream flow, and snow pack. Starting in April 2001, the agricultural producers in the Basin failed to receive deliveries of irrigated water. Crop destruction or damage, or the inability to plant crops, took place in 2001. Payments were made pursuant to section 2104 of the Act during October 2001. It is our understanding that all the affected taxpayers file their federal income tax returns on the basis of a calendar year.

LAW AND ANALYSIS

Issue 1

Section 451(d) of the Internal Revenue Code provides, in part, that a taxpayer reporting on the cash receipts and disbursements method of accounting may elect to include insurance proceeds received as a result of destruction or damage to crops in income for the taxable year following the taxable year of destruction or damage, if the taxpayer establishes that, under its practice, income from such crops would have been reported in a following taxable year. Section 1.451-6(a)(1) of the Income Tax Regulations provides, in part, that federal payments received as a result of destruction or damage to crops caused by drought, or the inability to plant crops because of drought, shall be treated as insurance proceeds received as a result of destruction or damage to crops for purposes of § 451(d).

Congress included the appropriation made in section 2104 of the Act to assist producers adversely affected by drought in the Klamath Basin region. 66 Fed. Reg. 51,637 (Oct. 10, 2001). Accordingly, taxpayers who received payments during 2001 pursuant to section 2104 of the Act; whose crops were destroyed or damaged

during 2001, or who were unable to plant crops in 2001; and who report on the cash receipts and disbursements method of accounting may elect to include such payments in income for 2002 if they can establish that, under their practice, income from irrigated crops that would have been grown during 2001 would be reported in a following taxable year.

Section 1.451-6(b)(1) of the regulations provides that the election must be made by means of a statement attached to the taxpayer's return (or an amended return) for the taxable year of destruction or damage, or inability to plant crops. The statement must include certain information listed in § 1.451-6(b)(1). If the only § 451(d) payments a taxpayer receives are a result of section 2104 of the Act, providing the following information will satisfy the requirements of the regulations: (1) the taxpayer's name and address; (2) a declaration that the taxpayer is making an election under § 451(d) and § 1.451-6; (3) identification of the specific irrigated crop(s) that were destroyed, damaged, or unable to be planted; (4) a declaration that under the taxpayer's normal business practice the income derived from the crop(s) would have been included in gross income for a taxable year following 2001; (5) the date(s) on which the crops were destroyed or damaged, or unable to be planted; and (6) the amount that was paid pursuant to section 2104 of the Act, the fact that it was paid by the U.S. Department of Agriculture, and the date of payment.

Issue 2

Section 1301 of the Code and § 1.1301-1 of the Income Tax Regulations provide rules relating to the election to average farm income in computing tax liability. Based on the nature of the payments received under section 2104 of the Act, we believe that individuals engaged in a farming business who can elect to average farm income under § 1301 may treat section 2104 payments as income attributable to a farming business for purposes of determining the amount of taxable income that is attributable to a farming business under § 1301(b)(1)(A)(i) and § 1.1301-1(e)(1).

Please call if you have any further questions about these issues.

Associate Chief Counsel
(Income Tax and Accounting)

By _____
CHRISTOPHER F. KANE
Chief, Branch 3