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Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol14/iss10/1

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Inconsistency in Handling Farm Income?
— by Neil E. Harl* and Roger A. McEowen**

With government farm payments making up close to half of net farm income (and nearly 100 percent in some states), the focus on how the subsidies are to be reported has taken on added importance. The problem is complicated by three features—(1) farmers can elect to have Commodity Credit Corporation loans (which is the vehicle for two of the three ways program benefits are delivered to farmers and landowners) treated as loans or as income; (2) the subsidies are delivered to eligible participants in three distinctly different systems of payments; and (3) dollar limitations on payments have been imposed by the Congress although in recent years Congress has provided a way to avoid the payment limitations. The latter involves the use of a special statute-based procedure which involves what are known as commodity certificates. The evidence indicates that the principal use of commodity certificates is for cotton and rice with a modest use for soybeans. Relatively little use of commodity certificates has been observed for corn and wheat.

Options for receiving subsidies

As noted, federal farm subsidies involving the production of the so-called “program commodities” (those for which a payment is provided) are made available to producers under three mutually exclusive options—

- One, the most widely used, is called a “loan deficiency payment” (LDP).

Example: Assume the upland cotton loan rate (which is set by Congress) is 52 cents per pound. A Commodity Credit Corporation loan (CCC is a federally chartered corporation formed essentially as fiscal agent of the U.S. Department of Agriculture) could be obtained for 52 cents per pound of eligible cotton.

With an LDP, however, a CCC loan is not obtained. Rather, a payment is made to the eligible participant (farm tenant, owner-operator or share-rent landowner) based upon the amount by which the loan rate exceeds the AWP (adjusted world price). Assuming the AWP is 32 cents per pound of cotton, the eligible participant would receive a payment of 20 cents per pound. The eligible participant would be ineligible for either of the other two options, but would still be able to benefit from the CCC program if the crop is sold before harvest or is forward contracted.

The 20 cents-per-pound payment would be—(1) reported to IRS and to the taxpayer on a Form CCC-1099G, Information Return and by the taxpayer on Schedule F; and (2) subject under federal income tax.

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to the payment limitation for combined marketing loan gains and LDPs. That limit is $75,000.11

- The second option, for eligible participants, is to use a “marketing loan” which produces a “marketing loan gain.”12

Example: Once again, assume a cotton loan rate of 52 cents per pound and an AWP of 32 cents per pound. The eligible participant would take out the loan at 52 cents per pound and could repay the loan at 32 cents per pound. That would produce a marketing loan gain of 20 cents per pound of cotton.

Again, the 20 cents-per-pound payment would be—(1) reported to IRS and to the taxpayer on a Form CCC-1099G, Information Return and by the taxpayer on Schedule F; and (2) subject to the payment limitation for marketing loan gains and LDPs of $75,000.

- The third option is to use a special procedure, the details of which were developed by the U.S. Department of Agriculture several years ago, using commodity certificates (which are available for wheat, upland cotton, rice, feed grains and oilseeds). With that procedure, the eligible participant takes out a CCC loan for the commodity at the loan rate and, in essentially the same transaction, purchases a commodity certificate of a size needed to repay the loan at the AWP.

Example: Again, assume a cotton loan rate of 52 cents per pound and an AWP of 32 cents per pound. Repayment of the CCC loan at 32 cents per pound produces a loan gain of 20 cents per pound of cotton.

The 20 cents per pound gain, however—(1) is not reported to IRS under current practice of the government agency involved and (2) does not count against the payment limitation. Indeed, this third option, involving commodity certificates, is typically used when the eligible participant expects to encounter the payment limitation.

The fact that the 20 cent per pound gain from this option does not count against the payment limitation has been specifically authorized by Congress.14

To sum up

In all three instances, if the eligible individual actually sells the upland cotton for 35 cents per pound, the eligible participant would have received a 20 cent per pound subsidy and would have realized (and recognized) 35 cents per pound on the actual sale of the commodity for a total of 55 cents per pound of cotton. The economic benefit under the three options is comparable (other than for the relief from the payment limitations) if the taxpayer in the third option reports properly the 20 cent per pound of gain on the exchange. If the taxpayer does not report the gain under the third option, the benefit of that option is proportionately greater by the amount of the income tax benefit from not reporting the gain.

The key questions are—(1) why does USDA not report the gains under the third option to IRS, as is done with the other two; and (2) what are the behavioral consequences of having two options with the gain reported to the IRS and the third is not?

Consequences of not reporting gain to IRS

Aside from the obvious issue of whether reporting of gain on commodity certificates is required (the authors know of no authority to excuse reporting), the concerns are—(1) the behavioral impact on taxpayers who know gain from options 1 and 2 are reported to IRS and the gain from option 3 is not (which really relates to the rate of compliance with tax law, i.e., whether the gain is properly reported by the taxpayer to IRS even though the U.S. Department of Agriculture (through the Farm Service Agency) did not report the gain as a matter of information reporting) and (2) perceptions of unfairness by taxpayers who are treated differently for essentially the same government benefit.

In conclusion

Additional guidance from the Internal Revenue Service is needed as to whether information reporting of gain by the government agency providing the subsidy is required. The importance of this matter is underscored by the fact that nearly $2 billion in commodity certificate gains was triggered in 2001.

FOOTNOTES

1 See generally, 11 Harl, Agricultural Law Ch. 91 (2003); Harl, Agricultural Law Manual § 10.03 (2003).
6 A fourth option, which has rarely been used in recent years, is to forfeit the commodity under loan to the Commodity Credit Corporation. See note 7 infra.
9 For most commodities, the reference is to the Posted County Price (PCP) on the date the loan is obtained.
10 The LDP must be applied for between the date of harvest and the date of title transfer but not later than the final loan availability date.