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Inconsistency in Handling Farm Income: The IRS Response
— by Neil E. Harl* and Roger A. McEowen**

In an article in the May 16, 2003, issue of Agricultural Law Digest,1 which was published in the May 12, 2003, issue of Tax Notes,2 an inconsistency in information reporting for one type of government farm program payments was discussed. That inconsistency involved information reporting by the Farm Service Agency of USDA to the Internal Revenue Service and to the taxpayer for benefits received under the federal farm program for “program commodities.”3

On March 18, 2004, IRS responded,4 conceding that the gain was taxable but refusing to require USDA to issue a Form 1099G to report the gain to the IRS and to the taxpayer for commodity certificate gains.

Options for receiving subsidies

Federal farm subsidies are paid in three forms: direct payments, which are paid regardless of commodity prices,5 countercyclic payments6 and marketing assistance benefits.7 All are to be reported as ordinary income.

The problem is with marketing assistance benefits which are paid under four different, mutually exclusive, methods of payment.8 One, the most widely used, is called a loan deficiency payment or LDP? The payment is made directly to the taxpayer based on the difference between the loan rate for the commodity and the “posted county price” (for most commodities except for cotton) or the difference between the loan rate and the “adjusted world price” (for cotton).9 With an LDP, no Commodity Credit Corporation loan is obtained. The benefit amount is reported to IRS and to the taxpayer on Form CCC-1099G, Information Return, and reported by the taxpayer on Schedule F. The payment is subject to the payment limitation of $75,000 per “person” for marketing assistance benefits.10

The second option, for eligible participants, is to use a “marketing loan” which produces a “marketing loan gain.”11 The benefit amount is the difference between the commodity loan rate and the PCP or AW at the time of repayment of the CCC loan. That amount is reported to IRS and the taxpayer on a Form CCC-1099G, and reported by the taxpayer on Schedule F, and is subject to the payment limitation of $75,000 for

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marketing loan gains and LDPs.

The third option involves a procedure whereby commodity certificates\(^{13}\) are purchased at the local FSA office and used to repay the CCC loan taken out by the producer of the commodity at the posted county price or the adjusted world price.\(^{14}\) The gain, which is comparable to the LDP benefits and marketing assistance benefits obtained when the CCC loan is repaid with cash, is not reported to IRS under the current practice of the USDA agency involved and does not count against the payment limitation of $75,000.\(^{15}\)

The fourth option is to forfeit the commodity to CCC in full satisfaction of the CCC loan (it is a non recourse loan). The benefit, again, is the difference between the commodity loan rate and the PCP or AW, this time on the date of forfeiture. That benefit is also reported to the IRS and the taxpayer (but on a Form 1099A, the information return used for abandonments) but does not count against the $75,000 payment limitation for marketing assistance benefits.

**IRS response**

The response of the Internal Revenue Service on March 18, 2004\(^{16}\) restated the above and conceded that the commodity certificate gain is taxable. But the Service refused to require USDA to issue a Form 1099G to report the gain to the IRS and the taxpayers for Commodity Certificate gains. The IR states:

“A farmer can use CCC certificates to facilitate repayment of a CCC loan. If a farmer uses cash instead of certificates, the farmer will receive a Form CCC-1099G Information Return showing the market gain realized. However, if a farmer uses CCC certificates to facilitate repayment of a CCC loan, the farmer will not receive any information return. Regardless of whether a CCC-1099-G is received, the market gain is either reported as income or as an adjustment to the basis of the commodity, depending on whether the special election has been made.”

By going that far but not requiring information reporting, the IRS has arguably focused attention on the moral hazard involved and, by acknowledging that the gain is taxable but refusing to order information reporting, has probably increased the incidence of nonreporting. A producer using commodity certificates to repay a CCC loan who does not receive a Form 1099, and knows that neighbors obtaining an LDP using a CCC repaid with money or forfeiting the commodity to CCC all do, may be inclined to conclude that the certificate gain is not taxable. A certificate-using farmer who reads IR-2004-38 knows that is not true—but not all producers read the IRS news releases.

As a solution, Congress could prescribe information reporting for all government farm program payments including commodity certificate gains. The Department of the Treasury alternatively could solve the problem by regulation.

The IRS in IR-2004-38 indicated that a farmer who reports CCC loans as income, and thus has an income tax basis in the commodity, accounts for the “market gain” by reducing the basis of the commodity. That mirrors what was authorized for gain on certificates in 1987.\(^{17}\)

**FOOTNOTES**


3 See Harl and McEowen, note 1 supra.


6 Id., Sec. 1104.

7 Id., Secs. 1201-1209.

8 Id.

9 Id., Sec. 1205.

10 See Harl and McEowen, note 1 supra.


12 Id., Sec. 1201.


14 See Harl and McEowen, note 1 supra.

