

# Commentary: Dispute on Reporting Government Farm Program Payments

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A battle has been brewing for several months on whether it's necessary for an agency of the United States Department of Agriculture (the Farm Service Agency or FSA) to report one category of federal farm program payments going to the largest farmers.<sup>3</sup> The controversy is not minor—it involved government payments of \$1,974,000,000 in 2001.<sup>4</sup>

The issue is discussed in depth in the recently revised Portfolio, *Reporting Farm Income*, TM 608-2d by Neil E. Harl and Roger A. McEowen.

## Payments involved

Under the 2002 farm bill,<sup>5</sup> three different forms of government payments are paid to producers of so-called program commodities (food grains, feed grains, cotton, rice and oil seeds). Direct payments are paid subject to a \$40,000 payment limitation per “person” and are not involved in this controversy, counter-cyclic payments are subject to a \$65,000 payment limitation per person and are likewise not involved in this dispute and marketing assistance payments which are, in general, subject to a payment limitation of \$75,000 per person.<sup>6</sup> In general, all payments are reportable as ordinary income but there are disagreements on whether the payments are subject to information reporting.<sup>7</sup>

The greatest concern is in the handling of marketing assistance benefits. Payments are made to producers when the market price for the particular commodity is below the so-called Commodity Credit Corporation loan rate. That category of subsidy can be obtained in four ways –

- The first option, the most common, is called a “loan deficiency payment” or LDP.

*Example:* Assume the cotton loan rate (which is set by Congress) is 52 cents per pound. A Commodity Credit Corporation loan could be obtained on the producer's cotton for 52 cents per pound with the cotton as collateral for the loan. With an LDP, however, the producer does not obtain a CCC loan. Rather, the producer, on sale of the cotton, receives a cash payment from the government for the difference between what is known as the Adjusted World Price (or AWP) which is roughly equal to the prevailing market price and the cotton loan rate. So if the AWP is 32 cents per pound at the time of sale, the producer receives a payment of 20 cents per pound (52 cent per pound loan rate minus the AWP of 32 cents per pound).

The 20 cents per pound payment is reported by FSA to IRS and the taxpayer on a Form 1099-G, Information Return and the payment is subject to the payment limitation of \$75,000 per person.

- The second option, for eligible participants, is to take out a CCC loan which produces a “marketing loan gain.”

*Example:* Once again, assume a cotton loan rate of 52 cents per pound and an AWP of 32 cents per pound. The producer would receive loan proceeds at the rate of 52 cents per pound. If the market price (or the AWP) falls to 32 cents per pound, the producer could repay the loan at 32 cents per pound and pocket the difference as a marketing loan gain. Such marketing loans can be repaid at the lesser of principal plus interest or the adjusted world price (AWP).

The 20 cents per pound of marketing loan gain is reported by FSA to IRS and the taxpayer on a Form 1099-G, Information Return and is subject to the payment limitation of \$75,000 per person.

- The third option involves a special procedure, the details of which were developed by USDA several years ago, using “commodity certificates” (which are available for wheat, cotton, rice, feed grains and oil seeds). With that procedure, the producer takes out a CCC loan and, in essentially the same transaction, purchases a commodity certificate to repay the loan at the adjusted world price.

*Example:* Again, assuming 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 with commodity certificates produces a loan gain of 20 cents per pound of cotton. The 20 cents of loan gain, however, is *not* reported by FSA to IRS under the current practice of the government agency involved (FSA) and the benefit does *not* count against the payment limitation of \$75,000 per person. Indeed, this third option, involving commodity certificates, is generally used when the producer expects to encounter the payment limitation.

- The fourth option is to forfeit the commodity to the Commodity Credit Corporation (a Congressionally chartered corporation). The gain involved (the difference between the CCC loan rate of 52 cents per pound of cotton and the AWP on forfeiture) is reported to the IRS and the taxpayer by the Farm Service Agency (FSA) on Form 1099-A (for abandonments). The gain involved does not, however, count against the payment limitation.

To sum up, in all four instances, the producer gets essentially the same economic benefit. However, in one instance (option three) the benefit amount is not reported to IRS and the taxpayer and in two of the instances (options three and four) the benefit does not count against the payment limitation.

## The IRS response

The response of the Internal Revenue Service, on March 18, 2004<sup>8</sup> was to restate the above with the Service conceding that the commodity certificate gain was taxable. But the Service refused to require USDA to issue a Form 1099-G to report the gain to the IRS and the taxpayers for the commodity certificate gains involved. The IR states—

“A farmer can use CCC certificates to facilitate payment repayment of a CCC loan. If a farmer uses cash instead of certificates, the farmer will receive a Form 1099-G, 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 CCC1099-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 [to reduce basis] has been made.”

By going that far but not requiring information reporting, 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-G, and knows that neighbors obtaining an LDP, using a CCC loan repaid with cash 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.

## In conclusion

If the USDA agency does not move to report the certificate gains, IRS should move to require such reporting. If IRS is unwilling, Congress should mandate information reporting for all government farm program payments, including commodity certificate gains.

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<sup>3</sup> See IR 2004-38. See also Harl and McEowen, “Inconsistency in Handling Farm Income?” 99 *Tax Notes* 923 (2003); Harl and McEowen, “Inconsistency in Handling Farm Income; One More Time,” 103 *Tax Notes* 476 (2004).

<sup>4</sup> See *Report of the Commission on the Application of Payment Limitations for Agriculture*, p. 82, August 2003, available online at <http://www.usda.gov/occe> (the senior author of this Commentary was a member of the nine-member Commission).

<sup>5</sup> Farm Security and Rural Investment Act of 2002, P.L. 107-171, 116 Stat. 134 (2002).

<sup>6</sup> *Id.*

<sup>7</sup> See note 3 *supra*.

<sup>8</sup> IR 2004-38.