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CRS Report for Congress

Payment Limits for Farm Commodity Programs: Issues and Proposals

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Summary

Payment limits set a maximum amount of farm commodity program payments per person. The House-passed version of the 2007 farm bill, H.R. 2419, would tighten some limits and relax others. It would impose a tighter adjusted gross income (AGI) cap to qualify for commodity payments (eliminating payments to households with adjusted gross income over $1 million, compared with the current $2.5 million), track payments to individuals, and disallow doubling for people with multiple farms. But it would raise limits on direct payments and eliminate limits on the marketing loan program.

The Administration's farm bill proposal would impose an even tighter income cap at $200,000 AGI, which is also the proposal in H.R. 2720 (Kind). An alternative approach is to tighten the limit on the payments themselves. S. 1486 (Dorgan/Grassley) would lower the maximum government payment to $250,000 from the current $360,000.

Tighter payment limits likely would affect more southern cotton and rice farms than midwestern feed grain and oilseed farms, thus dividing the issue more regionally than by political party. Tighter household income limits may not necessarily affect the same farms as a lower payment cap, since nonfarm sources of income raise adjusted gross income and large farms can have low net income. This report will be updated.

Background on Payment Limits

Dating from 1970, payment limits set a maximum amount of farm program payments that a "person" can receive (currently $360,000). In addition, the 2002 farm bill created an income test to exclude payments to those with high incomes (over $2.5 million adjusted gross income, unless 75% is from farming). The issue is controversial and usually focuses on what size farms should be supported, whether payments should be proportional to production or limited per individual, and the need to reduce spending.

The effect of payment limits varies greatly across individuals and regions. The South and West have more large farms than the Upper Midwest or Northeast. By commodity, cotton and rice farms are affected more often since subsidies per acre are relatively higher.

What Payments Are Subject to Limits? Producers generally receive three types of commodity payments: direct payments, counter-cyclical payments, and marketing loans. Applying limits to direct and counter-cyclical payments is relatively straightforward. Marketing loans are more complicated because limits do not apply to some marketing loan options (for background, see CRS Report RL33271, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*).

The following types of commodity payment are subject to limits (7 U.S.C. 1308):

- Direct payments
- Counter-cyclical payments
- Some marketing loan benefits:
  - Marketing loan gain (MLG): repaying a loan for less than the original amount and keeping the difference as a subsidy
  - Loan deficiency payment (LDP): a cash payment instead of a loan

Payments *not* subject to limits:

- Some marketing loan benefits:
  - Certificate gain (similar to MLG): repaying a loan with commodity certificates instead of repaying with cash or forfeiting[1]
  - Forfeiting the commodity and keeping the cash from the loan.

The 2002 farm bill also created an income test, prohibiting payments to entities with adjusted gross income (AGI, for tax purposes) greater than $2.5 million, unless 75% or more comes from farming (7 U.S.C. 1308-3a).

How Many Farmers Are Affected? In 2000, about 1% of producers receiving payments were affected by the $40,000 limit on what now are called direct payments. This amounted to 12,300 producers across 42 states. The reduction was $83 million, or 1.6%, with California and Texas accounting for 36% of the reduction.[2]

Masked by these data is the fact that limits can avoided, to some degree legally, by reorganizing a farm business.[3] In fact, one study suggests that about 20% of rice farmers have reorganized their business because of limits, despite only 1.2% appearing to be subject to the limit.[4] Thus, for tighter limits to have long-term effects, proposals need to incorporate restrictions on farm business restructuring and individual participation.

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[1] Under 7 U.S.C. 7286 (P.L. 106-78, sec. 812, Oct. 1999), farmers essentially buy certificates at a discount and use them to repay their loans, similar to repaying in cash. But, technically, a certificate exchange is not a MLG which is subject to limits; it is a momentary forfeiture to retire the loan, followed by "in-kind" receipt of commodities in exchange a certificate bought at a discounted price. This was designed to facilitate marketing and minimize forfeiture. USDA, *Report of the Commission on the Application of Payment Limitations for Agriculture*, Aug. 2003, pp. 80-83, at [http://www.usda.gov/oce/reports/payment_limits/paymentLimitsAll.pdf].

[2] USDA, pp. 65-75.

[3] USDA, pp. 31-39; GAO, *Farm Program Payments: USDA Needs to Strengthen Regulations and Oversight to Better Ensure Recipients Do Not Circumvent Payment Limitations.* GAO-04-407, April 2004, pp. 20-26 at [http://www.gao.gov/new.items/d04407.pdf].

[4] Barrett Kirwan (University of Maryland) "The Distribution of U.S. Agricultural Subsidies," p. 19-22, at [http://www.aei.org/docLib/20070515_kirwanfinal.pdf].

Current Payment Limits

Under the 2002 farm bill, the annual payment limit is $360,000 per person. Individuals, corporations, partnerships, and trusts are eligible. The limit has three parts: $40,000 for direct payments, $65,000 for counter-cyclical payments, and $75,000 for marketing loan gains and loan deficiency payments (**Table 1**). These amounts add to $180,000, but can be doubled, as described later.

The $360,000 limit is not a firm ceiling, however. Marketing loan benefits are essentially unlimited because producers can use commodity certificates without limit when other marketing loan options are limited. Cotton and, to a lesser extent, rice farms are the primary users of certificates. Corn, soybeans, and wheat use certificates minimally.

One way to double the limit is the "three entity rule," which allows one person to receive payments on up to three entities, with second and third eligible for one-half of the limits. The other is the "spouse rule," which treats a husband and wife as separate persons to double a farm's payment limit. Payments for most commodities are combined toward a single limit, but separate limits currently apply to peanuts, wool, mohair, and honey.

Table 1. Payment Limits on Farm Commodity Programs

<table>
<tr><th rowspan="2">Type of Limit</th><th>Current law</th><th colspan="3">Proposals</th></tr>
<tr><th>2002
Farm Bill</th><th>H.R. 2419
House-passed</th><th>USDA
proposal</th><th>S. 1486
(Dorgan)</th></tr>
<tr><td colspan="3">Adjusted Gross Income (AGI) Limitation</td><td></td><td></td></tr>
<tr><td rowspan="2">Ineligible for payments if AGI exceeds...</td><td rowspan="2">$2.5 million,
except if 75%
is from farm</td><td>$500,000,
except if 67%
is from farm,</td><td rowspan="2">$200,000
no exceptions</td><td rowspan="2">$2.5 million,
except if 75%
is from farm</td></tr>
<tr><td>and $1 million
no exceptions</td></tr>
<tr><td colspan="3">Direct and Counter-Cyclical Payments</td><td></td><td></td></tr>
<tr><td>(a) Direct Payments</td><td>$40,000</td><td>60,000</td><td>110,000</td><td>$20,000</td></tr>
<tr><td>(b) Counter-Cyclical Payments</td><td>$65,000</td><td>65,000</td><td>110,000</td><td>$30,000</td></tr>
<tr><td>Doubling allowance</td><td>Spouse
3-entity</td><td>Spouse</td><td>No doubling</td><td>Spouse
3-entity</td></tr>
<tr><td>Subtotal, after doubling</td><td>$210,000</td><td>$250,000</td><td>220,000</td><td>$100,000</td></tr>
<tr><td colspan="3">Marketing Loan Payments</td><td></td><td></td></tr>
<tr><td>(c1) Marketing Loan Gains
(c2) Loan Deficiency Payments</td><td>$75,000</td><td rowspan="4">Unlimited</td><td>$140,000</td><td rowspan="2">$75,000</td></tr>
<tr><td>(c3) Commodity Certificates
(c4) Loan Forfeiture Gains</td><td>Unlimited</td><td>Unlimited</td></tr>
<tr><td>Subtotal of (c1) and (c2), after doubling</td><td>$150,000</td><td>$140,000</td><td rowspan="2">$150,000</td></tr>
<tr><td>Subtotal including (c3) and (c4)</td><td>Unlimited</td><td>Unlimited</td></tr>
<tr><td colspan="3">Sum of Direct, Counter-Cyclical, and Marketing Loan Payments</td><td></td><td></td></tr>
<tr><td>Total of limited payments</td><td>$360,000</td><td>$250,000</td><td>$360,000</td><td rowspan="2">$250,000</td></tr>
<tr><td>Total including all marketing loan options</td><td>Unlimited</td><td>Unlimited</td><td>Unlimited</td></tr>
</table>

Source: CRS.

Policy Issues In Congress

Supporters of payment limits use both economic and political arguments to justify tighter limits. Economically, they contend that large payments facilitate consolidation of farms into larger units, raise the price of land, and put smaller, family-sized farming operations at a disadvantage. Even though tighter limits would not redistribute benefits to smaller farms, they say that tighter limits could help indirectly by reducing incentives to expand, and could help small and beginning farmers buy and rent land. Politically, they believe that large payments undermine support for farm subsidies and are costly.

Critics of payment limits counter that all farms are in need of support, especially when market prices decline, and that larger farms should not be penalized for the economies of size and efficiencies they have achieved. They say that farm payments help U.S. agriculture compete in global markets, and that income testing is at odds with federal farm policies directed toward improving U.S. agriculture and its competitiveness.

Many observers believe that Congress may consider payment limits during the 2007 farm bill debate, to the extent that the distribution and effect of subsidies are considered. Newspapers have published stories critical of farm payments and how they are distributed to large farms, non-farmers, or landowners.[5] Limits are increasingly appealing to urban lawmakers, and have advocates among smaller farms and social interest groups.

H.R. 2419. The House-passed farm bill makes several changes to payment limits, some tightening them and others relaxing them (see **Table 1**). CBO scores these changes to save about $50 million per year ($227 million over five years and $550 million over 10 years), which is about 0.6% of the $36.5 billion five-year commodities baseline.

H.R. 2419 tightens payment limits in three ways.

- **Reducing the AGI limit** to $500,000 for individuals who do not earn more than 67% of their income from farming, and to $1 million with no exceptions (down from the current $2.5 million with an exception). Some spouses may qualify for a separate application of the limit.
- **Eliminating the "three-entity rule,"** which allows individuals to double their payments by having multiple ownership interests. Individuals still may receive payments on multiple entities, but having multiple entities would no longer allow the limits to be doubled.
- **Requiring "direct attribution"** of payments to a natural person instead of to a corporation, general partnership, etc.

H.R. 2419 relaxes payment limits in two ways.

- **Raising the limit on direct payments** from $40,000 to $60,000.
- **Eliminating limits on the marketing loan program.** This is in response to perceived abuses of commodity certificates, which have been used to avoid the limit. Since the limit would be waived, certificates would be unnecessary. Others bills (S. 1486, below) take an opposite approach by making commodity certificates subject to payment limits.

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[5] For example, see the *Washington Post* series "Harvesting Cash," published in 2006, at [http://www.washingtonpost.com/wp-srv/nation/interactives/farmaid/].

H.R. 2720 and H.Amdt. 700 (Kind). The "Farm 21" proposal by Representative Kind, H.R. 2720, would tighten the AGI limit to $200,000, as proposed by the Administration, and leave other limits on payments unchanged. The Kind amendment on the House floor (H.Amdt. 700 to H.R. 2419, which failed by a vote of 117-309 and was much broader than payment limits) would have tightened the AGI limit to a firm $250,000 cap for everyone and $125,000 unless 66% of AGI came from farming.

USDA's AGI Proposal.[6] The Administration's farm bill proposal would deny commodity payments to households with more than $200,000 of adjusted gross income (AGI, for tax purposes), down from $2.5 million. It would not allow the current exemption from the test when 75% of AGI comes from farming. The Administration's plan also would redistribute the $360,000 limit across the payment types, eliminate the three-entity rule, and apply a single limit to all commodities. But it retains the exemption from limits for commodity certificates and forfeiture (**Table 1**). CBO's score of this plan would save $596 million over five years and $1.5 billion over 10 years, more than double the savings of the provision in H.R. 2419. It appeals to many as a reasonable plan to limit benefits using a commonly accepted notion of high income.

In 2004, about 25,000 farm proprietors (1.2%) and 13,000 share-rent landlords (2%) both received payments and had AGI over $200,000; these farms received about 5% of government payments.[7] These potentially affected farms are not necessarily large farms, nor necessarily above the AGI limit because of high *farm* income. AGI is a common measure of income, and combines income from all sources (farm and nonfarm, as well as individual, partnership, and corporate income from farming). AGI measures *net* income, and Schedule F farm income is added on a net basis, that is, after expenses. However, some critics of the proposal say a phase-out is needed so that households barely over the limit do not lose all their payments.

This proposal differs from prior year Administration proposals. In 2006 and 2005, the Administration proposed tighter payment limits by lowering the cap from $360,000 to $250,000, including commodity certificates and loan forfeiture under the limits, eliminating the three-entity rule, and applying limits to the dairy program.

Perspectives on Using Tax Data. Statistics about farmers' income taxes can be confusing since no single statistic reveals which farms might be affected. Farms overwhelmingly report losses for tax purposes (because of cash accounting, depreciation, and other practices), even though USDA farm income numbers are positive. For example, in 2004, 2 million Schedule F returns reported a net farm *loss* of $13 billion; two-thirds of these showed a loss. USDA farm income data show an $80 billion *profit*. Even for farms with sales over $250,000, about one-third report a loss for tax purposes.[8]

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[6] USDA's commodity proposal is at [http://www.usda.gov/documents/fbcommodity_071.pdf].

[7] USDA analysis of IRS data, unpublished, Feb. 2007.

[8] CRS analysis of IRS data at [http://www.irs.gov/taxstats/index.html], and USDA-ERS, *Effects of Federal Tax Policy on Agriculture*, by Ron Durst, James Monke, AER 800, April 2001, at [http://www.ers.usda.gov/publications/aer800/aer800.pdf].

Texas A&M published a study of the AGI proposal using representative farms.[9] The conclusion is that more farms may be affected than USDA's data suggests. However, the report does not address the peculiarities of taxable farm income such as cash accounting or depreciation, or whether the farm accounting data are comparable to taxable measures. Supporters of the AGI proposal say farmers are skilled at managing income taxes and can keep taxable farm income lower using tax incentives and rules.

S. 1486. Senators Dorgan and Grassley introduced S. 1486 in May 2007 to tighten limits on commodity payments to a total of $250,000, and count certificates and loan forfeiture toward the limits. The bill does not change the AGI limit as proposed by the Administration. A similar bill was introduced in the 109th Congress (S. 385, H.R. 1590).

S. 1486 would reduce the statutory limit (before doubling) on direct payments from $40,000 to $20,000; and the limit on counter-cyclical payments from $65,000 to $30,000. While the limit on marketing loans would remain the same at $75,000, the effective limit would decrease because commodity certificates and loan forfeiture would be counted toward the limit (**Table 1**). This is a key feature of the bill because, as a practical matter, marketing loan payments are not limited under the 2002 farm bill. When MLGs and LDPs hit the limit, producers can shift to commodity certificates without limit.

The bill would establish a new rule allowing a person with an interest in only a single farming operation to double the payment limits without needing to use the three-entity or spouse rules, both of which would continue. Thus, farmers would have another means and would find it easier to double the payment limits without changing their operations. The changes would apply to all of the program crops.

Regarding prospects for congressional support for tighter payment limits, there have been two votes in the Senate since 2002 that are specific to payment limits. The Senate-passed version of the 2002 farm bill contained tighter limits (S.Amdt. 2826 to S. 1731, 107th Congress). The vote was 66-31 in favor of tighter limits, but those limits were rejected by the conference committee. In 2005, Congress debated farm bill changes as part of budget reconciliation. A floor amendment by Senator Grassley to tighten payment limits failed by a procedural vote of 46-53 (S.Amdt. 2359 to S. 1932, 109th Congress).

H.R. 124. H.R. 124 (Fortenberry) promotes direct attribution by prompting new USDA regulations to reduce the use of schemes and multiple entities to avoid limits.

CBO Budget Options. The Congressional Budget Office's 2007 edition of *Budget Options* again proposes tighter payment limits to reduce agricultural spending.[10] The CBO suggestion would reduce direct and counter-cyclical limits by half, and count certificate gains and forfeiture toward the current marketing loan limit. CBO estimates this approach would save $1 billion over 10 years. This score may be a rough estimate for a score of S. 1486, since the basic approach is similar.

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[9] Agricultural and Food Policy Center (Texas A&M), "Impact of a Proposed AGI Means Test on Representative Crop Farms," Feb. 2007, at [http://www.afpc.tamu.edu/pubs/3/461/BP%2007-01.pdf].

[10] Congressional Budget Office, *Budget Options*, Feb. 2007, pp. 83-84, at [http://www.cbo.gov/ftpdocs/78xx/doc7821/02-23-BudgetOptions.pdf].