Order Code RS21493
Updated January 25, 2008

CRS Report for Congress

Payment Limits for Farm Commodity Programs: Issues and Proposals

Jim Monke
Specialist in Agricultural Policy
Resources, Science, and Industry Division

Summary

Payment limits both determine eligibility and set a maximum amount of commodity payments per person. Both the House and Senate versions of the 2007 farm bill, H.R. 2419, would tighten some limits and relax others. The House bill tightens the adjusted gross income (AGI) cap to $500,000 (compared with the current $2.5 million) unless farming contributes more than ⅔ of household income, and has a firm $1 million cap for everyone. The Senate bill makes smaller, slower changes to the AGI limit ($1 million in 2009, $750,000 in 2010, unless ⅔ of income is from farming), and does not have a firm cap. Both bills track payments to individuals and disallow doubling for people with multiple farms. But both repeal any limit on marketing loans.

Two Senate floor amendments on payment limits failed to get 60 votes to avoid a filibuster and thus were not adopted, including the Dorgan/Grassley amendment to lower the limit on payments from $360,000 to $250,000, and the Klobuchar amendment to tighten the AGI limit to $250,000 with an exception and $750,000 with no exceptions.

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

Payment limits date from 1970 and 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 because of questions about what size farms should be supported, and whether payments should be proportional to production or limited per individual. The effect varies across regions; the South and West have more large farms than the Upper Midwest or Northeast, and cotton and rice farms are affected more often since their subsidies per acre are 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 straightforward. Marketing loans are more complicated because payment limits do not always apply.

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) greater than $2.5 million, unless 75% comes from farming.

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.[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]

For the AGI limit, only about 3,100 (0.15%) farmers have AGI over $2.5 million. Since not all receive subsidies and some qualify for the 75% farm income exception, USDA estimates that the current AGI cap affects only a few hundred farmers.[5]

---

[1] Under 7 U.S.C. 7286, farmers essentially buy certificates at a discount and use them to repay their loans. But, technically, a certificate exchange is a momentary forfeiture, followed by "in-kind" receipt of commodities in exchange a certificate bought at a discounted price. 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; and 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].

[5] Ron Durst, *Effects of Reducing the Income Cap on Eligibility for Farm Program Payments*, USDA-ERS Report EIB-27, Sept. 2007 [http://www.ers.usda.gov/publications/eib27/eib27.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 Provisions

Type of Limit	Current law	2007 Farm Bill	
	2002 Farm Bill	**House H.R. 2419**	**Senate H.R. 2419**
Adjusted Gross Income (AGI) Limitation			
Ineligible for payments if AGI exceeds...	$2.5 million, except if 75% is from farm	$500,000, except if 67% is from farm, and $1 million no exceptions	2008: $2.5 m* 2009: $1.0 m* 2010: $750,000* * except if 67% is from farm
Direct and Counter-Cyclical Payments			
(a) Direct Payments	$40,000	$60,000	$40,000
(b) Counter-Cyclical Payments	$65,000	$65,000	$60,000
Doubling allowance	Yes: spouse, 3-entity	Yes: spouse	Yes: spouse
Subtotal, after doubling	*$210,000*	*$250,000*	*$200,000*
Marketing Loan Payments			
(c1) Marketing Loan Gains (c2) Loan Deficiency Payments	$75,000	Unlimited	Unlimited
(c3) Commodity Certificates (c4) Loan Forfeiture Gains	Unlimited		
Subtotal of (c1) and (c2), after doubling	*$150,000*		
Subtotal including (c3) and (c4)	*Unlimited*		
Sum of Direct, Counter-Cyclical, and Marketing Loan Payments			
Total of limited payments	***$360,000***	***$250,000***	*$200,000*
Total including all mkt. loan options	*Unlimited*	*Unlimited*	*Unlimited*

Source: CRS Report RS21493, *Payment Limits for Farm Commodity Programs: Issues and Proposals*.

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.

Both the House and Senate agriculture committees have considered payment limits during the 2007 farm bill debate. Newspapers have published stories critical of farm payments and how they are distributed to large farms, non-farmers, or landowners.[6] Limits are increasingly appealing to urban lawmakers, and have advocates among smaller farms and social interest groups.

House Farm Bill. House-passed H.R. 2419 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 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.

---

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

Senate Farm Bill. Like the House bill, the Senate-reported bill makes several changes to payment limits, some tightening them and others relaxing them (see **Table 1**). The Senate bill also preserves a separate limit for peanuts in current law; the House bill combines the limit for peanuts with other commodities. CBO has scored these changes to save about $191 million over five years and $456 million over 10 years.

The Senate-reported bill tightens payment limits in four ways.

- **Reducing the AGI limit** to $1 million in 2009 and to $750,000 in 2010 for individuals who do not earn more than 67% of their income from farming. Unlike the House bill, the Senate bill does not have a firm cap for everyone. Some spouses may qualify for a separate application of the limit. For the 2008 crop year, the payment limit would be unchanged from the current $2.5 million.
- **Eliminating the "three-entity rule"** like the House bill.
- **Requiring "direct attribution"** of payments like the House bill.
- **Reducing the counter-cyclical limit** from $65,000 to $60,000. The bill would apply the $60,000 limit to the revenue component of the average crop revenue (ACR) proposal.

The Senate-reported bill relaxes payment limits in one way.

- **Eliminating limits on the marketing loan program** like the House bill.

Dorgan/Grassley and Klobuchar Amendments. Two Senate floor amendments on payment limits failed to get 60 votes to avoid a filibuster and thus were not adopted. The first was an amendment by Senators Dorgan and Grassley (S.Amdt. 3695 to H.R. 2419) to lower the limit on payments. It did not achieve a 60-vote requirement despite a receiving a majority vote of 56-43. It is similar to S. 1486 by the same Senators in that it would have tightened limits on commodity payments to a total of $250,000 and counted certificates and loan forfeiture toward the limits. The amendment would not have changed the AGI limit. The amendment would have reduced 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 have remained the same at $75,000, the effective limit would have decreased because commodity certificates and loan forfeiture would have been counted toward the limit. This was a key feature because, as a practical matter, marketing loan payments are not limited under the 2002 farm bill or either version of H.R. 2419. When MLGs and LDPs hit the limit, producers can shift to commodity certificates without limit.

The second amendment was by Senator Klobuchar (S.Amdt. 3810 to H.R. 2419) to tighten the AGI limit. It did not achieve a 60-vote requirement despite receiving a plurality vote of 48-47. The amendment would have reduced the AGI limit to $250,000 unless more than 67% of AGI is farm income, and to $750,000 with no exceptions. This amendment would have imposed a firm upper limit like the House bill, and tighter AGI limits than either the House or Senate bills.

Before these 2007 votes on payment limits, there were two other votes in the Senate since 2002 that were 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).

Kind Amendment/"Farm 21". The so-called "Farm 21" proposal by Representative Kind, H.R. 2720, to broadly reform commodity programs, would have tightened the AGI limit to $200,000, as proposed by the Administration, and leave other limits on payments unchanged. A related amendment by Representative Kind on the House floor (H.Amdt. 700 to H.R. 2419) failed by a vote of 117-309. The amendment 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.[7] The Administration's farm bill proposal would deny commodity payments to households with more than $200,000 of AGI. 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.

USDA data suggest about 1.5% of farm operator households have AGI over $200,000 and receive some farm program payments (1.1% of farm sole proprietorships, 2.5% of farm partnerships, and 9.7% of farm households involved in farming through a corporation). About 8.5% of rice farms and 9.3% of cotton farms have AGI over $200,000 and receive program payments. This compares to 5.5% for corn farms and only 1.3% for soybean farms.[8] These potentially affected farms are not necessarily large farms, nor necessarily above the AGI limit because of high *farm* income. 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.

Perspectives on Using Tax Data. AGI is a common measure of household taxable income, and combines income from all sources. AGI measures *net* income, and Schedule F farm income contributes to AGI on a net basis, that is, after expenses. 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, two-thirds of Schedule F tax returns showed a loss, resulting in a net farm *loss* of $13 billion for all Schedule F returns. By comparison, USDA farm income data showed an $80 billion *profit*. Even for "large" farms with sales over $250,000, about one-third report a loss for tax purposes.[9]

---

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

[8] Ron Durst, USDA-ERS, at [http://www.ers.usda.gov/publications/eib27/eib27.pdf].

[9] 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 and James Monke, AER 800, April 2001, at [http://www.ers.usda.gov/publications/aer800/aer800.pdf].