

# Farm Program Planning Strategies Under the OBBBA During a Challenging Farm Economy

Roger McEowen ([roger.mceowen@washburn.edu](mailto:roger.mceowen@washburn.edu)) – Washburn University School of Law

Roger McEowen's Blog: <https://www.lexblog.com/author/roger-mceowen/>

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## Overview

Facing compressed operating margins, elevated interest rates, and fluctuating trade dynamics, producers are increasingly forced to reevaluate their foundational business structures. Operational decisions that once seemed routine - such as signing a bank loan renewal or selling an underutilized combine - now carry sophisticated, sometimes hidden, tax and regulatory consequences.

By coupling operational agility with proactive tax planning - such as auditing ownership splits to protect OBBBA payment limits and streamlining multi-tiered entities to avoid the four-layer transparency wall - family-owned operations can fully leverage expanded safety nets and emergency deductions to insulate themselves from market volatility and preserve operational equity for the next generation.

## 1. The Phantom Tax Traps of Entity Restructuring

For decades, the general partnership has been a traditional vehicle for family farming operations. Moving from a general partnership to a Limited Liability Company (LLC) is commonly viewed as a tax-free "non-event"—essentially maintaining the same owners, the same machinery, and the same land. However, while the underlying assets remain unchanged, the legal character of the operation's liability shifts dramatically under Internal Revenue Code (IRC) Section 752, introducing severe structural tax risks if debt allocations are mismanaged.

Due to decades of intensive tax planning—including prepaid farm expenses, rapid equipment depreciation via Section 179 and bonus expensing, and accumulating operating loans—many mature family farms maintain a negative tax capital account balance. In a general partnership, this negative balance is naturally insulated because every general partner remains personally liable for the entity's debt obligations. Under IRS rules, this recourse debt provides the necessary tax basis to support those negative balances without triggering gain recognition.

**The Core Risk:** *When transitioning to an LLC, all debts legally shift from recourse to nonrecourse by default unless explicit personal guarantees are executed. If two partners step up to guarantee a bank loan while a third partner is omitted or released from the paperwork, that third partner's share of liabilities drops immediately to zero.*

Under the strict mechanical operations of Subchapter K, the IRS views a reduction in a partner's share of debt as a constructive distribution of cash under IRC § 752(b). If this constructive cash distribution exceeds the partner's remaining tax basis, the excess is immediately treated as a taxable gain under IRC § 731(a)(1). To make matters worse, because farm assets frequently consist of heavily depreciated machinery, this 'phantom gain' does not qualify for preferential long-term capital gains rates; instead, it is largely triggered as ordinary income via depreciation recapture under IRC § 1245.

Practitioners should ensure that sufficient basis is preserved through appropriate liability allocations, guarantees, deficit restoration obligations, or other planning mechanisms before the restructuring is completed.



## 2. The OBBBA Subchapter K and S Corporation Direct-to-Owner Pivot

For operations organized as LLCs or S corporations, the OBBBA has fundamentally re-engineered how safety net commodity payments are distributed and qualified for under federal farm programs. Historically, the Farm Service Agency (FSA) enforced strict adjusted gross income (AGI) means tests directly at the entity level. If a farm entity experienced a single highly profitable year or crossed the statutory income ceiling, the entire operation faced absolute disqualification from receiving safety net payments, penalizing all owners regardless of their personal financial status.

The OBBBA substantially alters this dynamic by ignoring the business entity's consolidated earnings and evaluating the income threshold strictly at the individual owner level. For instance, if an LLC is comprised of three equal partners, the entity effectively receives three separate payment limit evaluations. If two partners individually qualify under the income limitations while the third partner exceeds them, the entity only loses the third partner's pro-rata share. The qualifying partners are no longer structurally punished for the high-income status of their co-owner.

**Example:** Assume an LLC receives a potential \$120,000 commodity payment and has three equal owners. If one owner exceeds the applicable AGI limitation while the other two qualify, the operation may retain eligibility for approximately two-thirds of the payment rather than losing the entire benefit.

Despite this favorable shift, ownership splits require diligent scrutiny. Ownership percentages now dictate the exact scale of payment vulnerability. If a majority stakeholder holding the lion's share of equity breaks the individual income limit, the operation will lose the vast majority of its payout. Producers must carefully audit and plan their ownership structures prior to the upcoming crop year to optimize safety net eligibility.

**Note:** Any restructuring undertaken to maximize payment eligibility should be coordinated with the operation's estate and succession plan. Altering ownership percentages solely to increase program benefits can create unintended gift tax consequences, affect future basis adjustments, and disrupt long-term transition planning.

## 3. The Four-Layer Transparency Limit in Farm Program Payments

As modern operations utilize increasingly sophisticated multi-tiered entities for asset protection, estate planning, and business succession, they must remain acutely aware of the FSA's strict structural transparency limits. When distributing program dollars, the FSA utilizes look-through rules to trace funding through corporate structures until it identifies the living individuals behind the business. However, federal law enforces an absolute statutory barrier to this tracing: tracking terminates precisely after four distinct levels of ownership.

The operational mechanism behaves like a multi-tiered corporate family tree:

- **Level 1:** The primary operating farm entity receiving the payment.
- **Level 2:** A corporate holding company or operating equipment LLC.
- **Level 3:** A management company or family limited partnership.
- **Level 4:** A family trust or secondary entity.



If a living human individual does not surface by the fourth layer of ownership, the tracing hits a statutory wall. For payment-limitation purposes, attribution generally ceases after the fourth ownership level, which can result in the loss of payment eligibility attributable to ownership interests that cannot be traced to an eligible individual. Consequently, the portion of the payment tied to that deeper entity is permanently forfeited. This reduction is not driven by a regulatory violation or non-compliance; it is a purely mechanical penalty resulting from excessive paperwork and layers.

Operations utilizing stacked companies or complex trusts must carefully map their ownership chains to ensure that human beneficiaries surface clearly before reaching the fourth-level restriction.

#### 4. Capital Asset Disposals and the Muddy Waters of Estimated Taxes

With operational margins tightening, many farmers are strategically consolidating capital or selling off underutilized machinery. However, doing so under current IRS interpretations creates significant uncertainty regarding the qualifying rules for quarterly estimated tax payments. Traditionally, qualified farmers enjoy an invaluable administrative exception: if they derive at least two-thirds ( 66.67% ) of their gross income from farming, they can bypass the burden of quarterly estimated tax filings entirely. Instead, they can opt to make a single estimated payment in January or file their return and pay their total liability by March 1st with zero underpayment penalties.

Clearing this two-thirds gross income hurdle requires a precise classification of revenue, which is where machinery and equipment disposals create administrative friction. When a tractor, combine, or implement is sold, the gain generated—frequently substantial due to historic depreciation deductions—must be categorized. If those dollars qualify as gross income from farming, they assist the producer in clearing the two-thirds threshold. If they are excluded, a significant machinery sale can inadvertently disqualify a producer, exposing them to retroactive underpayment penalties.

The IRS's internal posture on this issue has fluctuated considerably. Historically, the agency excluded equipment gains from farm gross income, later reversing course to include them. In the most recent revisions of the IRS Publication 225 (Farmer's Tax Guide), the agency quietly removed the explicit, clear written narrative authorizing the inclusion of equipment sales. However, the IRS left an active, unrevised computational example within the text that continues to count equipment sales toward the farm income total. This contradiction leaves producers in a regulatory gray area, making early consultation with an agricultural tax specialist essential before relying on machinery sales to defer estimated tax deadlines.

**Caution:** *The same classification issues may arise with gains from breeding livestock sales, draft animals, and other farm business assets, making annual gross-income computations particularly important when producers are attempting to qualify for the farmer estimated-tax exception.*

#### 5. Strategic Survival in an Economic Downturn

A recent economic forecast by a group of ag economists points toward a challenging agricultural environment characterized by compressed margins, elevated interest rates, and softened export volumes to major historical trade destinations like China. Despite these challenges, modern producers possess an arsenal of sophisticated financial and tax mitigation tools that were entirely unavailable during previous cyclical downturns, such as the 1980s farm crisis.



**Note:** *In a period of elevated borrowing costs, preserving working capital is often more important than minimizing taxes. Producers should evaluate whether aggressive expensing elections create future liquidity constraints by generating tax deductions today while reducing deductions available in future years.*

Chief among these modern statutory defenses is the OBBBA's permanent restoration of 100% first-year bonus depreciation. This mechanism allows operations to immediately expense and write off the full purchase price of major capital assets, including specialized machinery, implements, and grain storage facilities, rather than amortizing those costs over extended recovery periods.

Furthermore, producers can combine this with flexible tax planning strategies, such as:

- **Deferred-Payment Contracts:** Shifting grain or livestock revenue into the subsequent tax year to lock in prices while managing the current year's bracket thresholds.
- **Farm Income Averaging (IRC § 1301):** Spreading current taxable income over the preceding three tax years to smooth out spikes and mitigate the impact of progressive tax brackets.
- **Installment-Sales (IRC §453):** Where appropriate, installment-sale treatment may allow recognition of gain over multiple tax years, smoothing taxable income and preserving eligibility for various deductions, credits, and farm-program limitations.
- **New IRC §1062:** Also, the OBBBA creates new IRC §1062 which allows the gain on the sale of farmland to a buyer that continues farming the land for 10 years to be paid in four equal installments if all statutory requirements are satisfied.
- **Active Ownership Structuring:** Taking advantage of revised farm program rules that permit family-held LLCs to maximize and expand their total payment eligibility based on the documented active management and participation of the individual owners.

While macro trade patterns show a decline in direct shipments to China, global demand continues to diversify across alternative international markets. By coupling operational agility with rigorous entity planning and proactive tax structuring, family-owned agricultural enterprises can successfully insulate themselves from market volatility and preserve operational equity for the next generation.



## Conclusion

Surviving an era of compressed operating margins, elevated interest rates, and shifting international trade dynamics demands that modern agricultural operations look beyond field management and focus on corporate and tax precision. The economic downturn cannot be countered by productivity alone; it requires a defensive posture rooted in structural and regulatory optimization. Every safety net dollar and tax deduction counts toward preserving family equity. Failing to audit entity ownership splits under the new OBBBA rules can cause a farm to inadvertently forfeit its safety net payments based on a single owner's personal financial picture. Similarly, letting complex estate and liability plans drift past the FSA's strict four-layer transparency wall will cause critical program payments to permanently vanish.

These cash flow losses are entirely avoidable, triggered not by a failure of the farm itself, but by unexamined paperwork. Ultimately, the path through a challenging economic market is paved with proactive adjustments. By taking immediate steps—such as securing explicit personal debt guarantees before executing an LLC transition, coordinating with an accountant on equipment sale timing, and utilizing tools like 100% bonus depreciation and farm income averaging—producers can effectively insulate themselves from macro-level volatility.

The producers who emerge strongest from the current downturn are unlikely to be those with the highest yields or largest acreage. Rather, they will be the operations that integrate tax planning, entity design, farm-program eligibility, and succession planning into a unified business strategy. In the post-OBBBA environment, those disciplines are no longer separate planning exercises - they are increasingly inseparable components of farm profitability.

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