Federal Farm Programs: Organizational Structure Matters – Part One

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August 2022
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
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Overview

How a farming operation is legally structured influences eligibility for federal farm program payment limitations and the amount of payments that can be received. The eligibility rules for participation in the federal farm programs date to 1970. In essence, the rules are designed to ensure that the public taxpayer dollars flow to persons or entities that are actually engaged in farming activities. The rules also cap the amount of payments that an eligible "person" can receive on an annual basis, and exclude from participation persons and entities with gross income exceeding a threshold amount.

The rules can become quite complex in their application, but a basic point should not be missed – each "separate person" is entitled to a payment limit. The structure of the farming operation also can significantly impact separate person status and, in turn, the amount of payments a farming operation may receive.

Note: The longstanding payment limitation rules were relaxed for crop years 2018 and 2019 as an aid to farmers faced with retaliatory tariffs placed on U.S. ag goods by China in response to U.S. attempts to battle Chinese unfair trade practices, including theft of U.S. intellectual property.

Today's post is the first of a three-part series on the federal farm programs and how a farming operation can be organized to optimize government payments. In Part one today I look at the available program benefits. That will lay the groundwork at the farm program payment limitation rules and how a farm business can be structured within the rules to maximize payments.

Background – What's at Stake

Primary programs. The current farm program eligibility and payment limit rules were established under the 2014 Farm Bill and largely continued with the 2018 Farm Bill. Under those rules, the total amount of payments received, directly and indirectly, by a "person" or legal entity (except joint ventures or general partnerships) for Price Loss Coverage (PLC) Agricultural Risk Coverage (ARC), marketing loan gains, and loan deficiency payments (other than for peanuts), may not exceed $125,000 per crop year. A person or legal entity that receives payments for peanuts has a separate $125,000 payment limitation ($250,000 for married persons). Cotton transition payments are limited to $40,000 per year. For the livestock disaster programs, there is no annual limitation applies for payments under the Livestock Indemnity Program, the Livestock Forage Program, or the Emergency Assistance for Livestock, Honeybees and Farm-Raised Fish program (but adjusted gross income (AGI) limits apply. The same is true of the Tree Assistance Program. A separate $50,000 limitation applies with respect to the Conservation Reserve Program (CRP). There is also no payment limit for marketing assistance loans (marketing loan gain or deficiency payment).

A farmer can also elect to participate in the non-insured crop disaster assistance program on any commodity for which crop insurance is not available. Coverage is available up to 65 percent of production and 100 percent of average market price. The $125,000 per person payment limit applies on an entity-by-entity basis. A farmer can buy additional protection that is subject to a separate $300,000 payment limit.

Various environmental programs have separate limits. For example, the Environmental Qualify Incentives Program (EQIP) has an overall payment limit of $300,000 over a six-year period. The AGI limit is $1,000,000, but the limit is eliminated if at least two-thirds of AGI is from farming. The Conservation Stewardship Program (CSP). The limit for all CSP contracts combined is $40,000 per year ($200,000 over a five-year period. For the Conservation Contract Program there is no limit. This program allows a farmer to reduce FSA loans that are secured by real estate by up to one-third of the loan principal.

Summary: With the exceptions noted above, each "person" is, in general, entitled to a $125,000 payment limit. Through legal structuring of the business, a farming operation may be entitled to multiple payment limits. Conversely, improper (or no) planning could limit the farming operation to a single payment limit.

Beginning in 2014, farmers were given a one-time opportunity to elect PLC or ARC for the 2014-2018 crop years. If an election was not made, PLC applied beginning in 2015 with no payment available for 2014. If ARC was elected, *all* producers with respect to a farm had to sign the election form. If PLC was elected, the owners of the farm had an option to update their yields to 90 percent of their average yields from 2008-2012. All farm owners also could elect to reallocate their base acres based on the actual plantings for 2009-2012. Under the 2018 Farm Bill the rule was changed. For the 2019 and 2020 crop years, an election could be made. Now, the 2021-2023 crop years have a separate election. But, the combined annual payment limit for ARC/PLC remains $125,000 per person or entity.

PLC and ARC. The PLC option works in tandem with a crop insurance Supplemental Coverage Option (SCO). It is a risk management tool that is designed to address significant, multiple-year price declines. It compliments crop insurance, which is not designed to cover multiple-year price declines. A farmer that chooses the PLC option will receive a payment (consistent with payment limitations) when the effective price of a covered commodity is less than the target ("reference") price for that commodity established in the statute. The effective price is the higher of the mid-season price or the national average loan rate for the covered commodity. Thus, the PLC payment rate is the reference price less the effective price, and the PLC payment amount is the payment rate times the payment acres. Putting it another way, the PLC payment is equal to 85 percent of the base acres of the covered commodity times the difference between the target price and the effective price times the program payment yield for the covered commodity. SCO provides additional county-level insurance coverage not to exceed the difference between 86 percent and the coverage level in the individual insurance policy. Because SCO is a form of crop insurance, payment limits do not apply. But, a farmer selecting the PLC option must pay an additional premium for SCO coverage (but, the cost of the additional premium is 65 percent taxpayer subsidized).

ARC is a risk management tool that addresses revenue losses. Under the ARC, payments are issued when the actual county crop *revenue* of a covered commodity is less than the ARC county guarantee for the covered commodity and are based on county data, not farm data. A producer electing ARC must unanimously select whether to receive county-wide coverage on a commodity-by-commodity basis or choose individual coverage that applies to all of the commodities on the farm. Payment acres are 85 percent of base acres for county coverage, and 65 percent for individual farm coverage. Under ARC, a producer must incur at least a 14 percent loss (defined as 86 percent of benchmark revenue) for coverage to kick-in. The ARC county guarantee equals 86 percent of the previous five-year average national farm price, excluding the years with the highest and lowest price (the ARC guarantee price), times the five-year average county yield, excluding the years with the highest and lowest yield (the ARC county guarantee yield). This guarantee revenue is based on five-year Olympic production and average crop price excluding the high and low years. Both the guarantee and actual revenue are computed using base acres, not planted acres. The payment is equal to 85 percent of the base acres (this is for county-elected ARC) of the covered commodity times the difference between the county guarantee and the actual county crop revenue for the covered commodity, not to exceed 10 percent of the benchmark county revenue (the ARC guarantee price times the ARC county guarantee yield). In other words, if revenue is less than 76 percent of the previous five-year

average national farm price, then the maximum 10 percent of benchmark revenue is paid, subject to the payment limit of $125,000 per person.

Observation: When covered crop prices are relatively high, ARC is more likely to result in a payment to a producer. When prices are low, PLC will result in a payment. In general, the bigger margin between expected prices and reference prices, the more likely it is that a producer would choose ARC. The ARC/PLC decision was made by an irrevocable election – whatever a producer elected in 2014 applied through the 2018 crop year, and the only way to make a new election was by having acres come out of CRP that were then put back into production. As noted, the irrevocable election is no longer the rule.

Payments for PLC and ARC are issued after the end of the respective crop year, but not before Oct. 1. Thus, the 2021 crop payment will not be made until after October 1, 2022. From a practical/procedural standpoint, because a payment (if any) will not be issued until at or near the end of the producer's marketing year, lenders could have a more difficult time determining a producer's cash flow for crop loans.

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