



## **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. Limits were created in 1970 and continue today. Federal deficits and perceived inequities in the distribution of payments have heightened congressional attention. The Administration's proposal for the 2007 farm bill would impose a tighter income cap to qualify for government payments (means testing). H.R. 124 would mandate new rules to reduce the use of schemes to avoid limits. Other bills addressing payment limits are expected as lawmakers continue to consider the distribution and effect of subsidies.

Tighter payment limits would likely affect more southern cotton and rice farms than midwestern feed grain and oilseed farms. Fewer acres of cotton or rice are needed to reach the limit, since payments per acre are higher. Tighter household income limits may not necessarily affect the same farms, as nonfarm sources of income affect means testing and some large farms may have low net income. This report will be updated.

### **Background on Payment Limits**

Payment limits, which have existed since 1970, set a maximum amount of farm program payments a "person" can receive (7 U.S.C. 1308). In addition, the 2002 farm bill created an income test to exclude payments to households with very high incomes. The issue was controversial for the 2002 farm bill, and remains so today. The debate 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 payments: direct payments, counter-cyclical payments, and marketing loans. Applying payment limits to direct and counter-cyclical payments is relatively straightforward, since they are direct cash transfers. Marketing loans are more

complicated because limits do not apply to some marketing loan options (see CRS Report RL33271, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*, by Jim Monke).

The following types of payment are subject to limits:

- 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 marketing loan benefit
  - loan deficiency payment (LDP): a cash payment instead of a loan

Payments not subject to limits include:

- Some marketing loan benefits
  - certificate gain (similar to MLG): repaying a loan with commodity certificates instead of cash (P.L. 106-78, § 812, exempts these from limits)
  - 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 greater than \$2.5 million, unless 75% or more comes from farming.

Other farm programs have payment limits per person. These include the Milk Income Loss Contract (MILC, 2.4 million pounds of milk annually), Conservation Reserve Program (\$50,000), and Environmental Quality Incentives Program (\$30,000).

**Who Receives Payments?** Individuals, corporations, partnerships, and trusts are eligible. One-third of the 2 million farms in the United States receive subsidy payments, although the ratio is as high as 72% in North Dakota and 70% in Iowa. About 700,000 farm operators and 1 million landlords receive payments. The impact of limits can be minimized legally by creating multiple entities to receive payments.<sup>1</sup>

**How Many Farmers Are Affected?** Although data are available on the *distribution* of payments, few data are available on the current effect of *payment limits*. The 2003 report of the Payment Limits Commission provided data relevant to one of the three current payments.<sup>2</sup> 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 in direct payments was \$83 million, or 1.6%. Payment reductions in California and Texas represented 36% of the total reduction. Cotton farmers accounted for 60% of the cut in California and 35% of the cut in Texas. In December 2006, USDA released a new database that attributes payments to individuals better than previous data releases, but analyses have yet to be published because of the complexity of the raw data.

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<sup>1</sup> Food and Agriculture Policy Research Institute (University of Missouri), *Analysis of Stricter Payment Limits: Additional Information*, June 2003, p. 2, at [[http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI\\_UMC\\_Report\\_06\\_03.pdf](http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI_UMC_Report_06_03.pdf)]; and USDA, *Report of the Commission on the Application of Payment Limitations for Agriculture*, Aug. 2003, pp. 31-39, at [[http://www.usda.gov/oce/reports/payment\\_limits/paymentLimitsAll.pdf](http://www.usda.gov/oce/reports/payment_limits/paymentLimitsAll.pdf)].

<sup>2</sup> *Report of the Commission on the Application of Payment Limitations for Agriculture*, pp. 65-75.

## Current Payment Limits

Under the 2002 farm bill, the annual payment limit is \$360,000 per person. 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. These amounts add to \$180,000, but can be doubled (see **Table 1**). 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.

One way to double the limit is the “three entity rule,” allowing one person to receive payments on up to three entities, with second and third entities 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 apply to peanuts, wool, mohair, and honey.<sup>3</sup>

**Table 1. Payment Limits on Farm Commodity Programs**

Type of Limit	Current law	Proposals	
	2002 Farm Bill	(109 <sup>th</sup> Congress) S. 385 / H.R. 1590	Administration 2007 farm bill proposal
<b>Direct and Counter-Cyclical Payments</b>			
(a) Direct Payments	\$40,000	\$20,000	110,000
(b) Counter-Cyclical Payments	\$65,000	\$30,000	110,000
Doubling allowance	\$105,000	\$50,000	None
<i>Subtotal</i>	<i>\$210,000</i>	<i>\$100,000</i>	<i>220,000</i>
<b>Marketing Loan Payments</b>			
(c1) Marketing Loan Gains (c2) Loan Deficiency Payments	\$75,000	\$75,000	\$140,000
(c3) Commodity Certificates (c4) Loan Forfeiture Gains	No limit		No limit
Doubling allowance	\$75,000	\$75,000	None
<i>Subtotal of (c1) and (c2)</i>	<i>\$150,000</i>	<i>\$150,000</i>	<i>\$140,000</i>
<i>Subtotal including (c3) and (c4)</i>	<i>No limit</i>		<i>No limit</i>
<b>Sum of Direct, Counter-Cyclical, and Marketing Loan Payments</b>			
<i>Total of (a), (b), (c1) and (c2)</i>	<i>\$360,000</i>	<i>\$250,000</i>	<i>\$360,000</i>
<i>Total including (c3) and (c4)</i>	<i>No limit</i>		<i>No limit</i>
<b>Adjusted Gross Income (AGI) Limitation</b>			
Ineligible for payments if AGI exceeds...	\$2.5 million except if 75% is from farming	no change	\$200,000 no exceptions

Source: CRS.

<sup>3</sup> See the USDA fact sheet “Payment Eligibility and Limitations” (July 2003), at [<http://www.fsa.usda.gov>].

## 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 public 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.

In August 2003, the Payment Limits Commission (created by the 2002 farm bill) provided a detailed report to Congress. The report has extensive data on program payments and limits, but the commission ultimately did not take a position other than that any changes should wait until the next farm bill.

Many observers believe that the 110<sup>th</sup> Congress may consider payment limits during the 2007 farm bill debate as part of overall consideration of the distribution and effect of subsidies. Newspapers have published stories critical of farm payments and how they are distributed to large farms, nonfarmers, or landowners.<sup>4</sup> Limits are increasingly interesting to urban lawmakers, and have advocates among smaller farms and social interest groups.

**Administration Proposals.**<sup>5</sup> The Administration's 2007 farm bill proposal would deny any commodity payments to households with adjusted gross income (AGI, for tax purposes) exceeding \$200,000 — down from the current \$2.5 million income test — and would not allow the exemption for households with 75% of income from farming. The Administration's plan would redistribute the \$360,000 limit across the payment types, eliminate the three-entity rule, and apply a single limit to all commodities, but retain the exemption from limits for commodity certificates and forfeiture (**Table 1**). The Administration estimates this plan would save \$1.5 billion over 10 years and appeal as a reasonable plan to limit benefits using a commonly accepted notion of high income.

The 2007 farm bill 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.

Regarding the continued ability to use commodity certificates to avoid limits under its proposal, USDA asserts that fewer cotton and rice farms (the primary users of

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<sup>4</sup> For example, see the Washington Post series *Harvesting Cash*, published in 2006, at [<http://www.washingtonpost.com/wp-dyn/content/linkset/2006/07/10/LI2006071000403.html>].

<sup>5</sup> USDA's 2007 farm bill proposal is available at [[http://www.usda.gov/wps/portal/!ut/p/\\_s.7\\_0\\_A/7\\_0\\_1OB?navid=FARM\\_BILL\\_FORUMS](http://www.usda.gov/wps/portal/!ut/p/_s.7_0_A/7_0_1OB?navid=FARM_BILL_FORUMS)].

commodity certificates) will use certificates to exceed payment limits on marketing loans because another part of its farm bill proposal would reduce marketing loan benefits.

This different approach using means testing could help achieve “direct attribution” of payments to individuals, a goal seeking to reduce “schemes” by which producers create various entities to avoid limits. 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 farm income is added on a net basis also, 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.

H.R. 124 also promotes direct attribution, but through new USDA-issued regulations that would be aimed to reduce the use of schemes and multiple entities to avoid limits.

Statistics about farmers’ income taxes can be confusing since no single statistic reveals which farms might be affected. Farm income may be reported on Internal Revenue Service (IRS) forms Schedule F (sole proprietor), Form 4835 (farm rental income), Schedule K-1 (partnership), and Schedule C (corporation). Most farms file Schedule F, but data are difficult to obtain for partnerships and corporations. Moreover, 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. That ratio is reversed for the approximately 80,000 Schedule F “large farms” with sales over \$250,000. About one-third of all Schedule F forms have government payments, compared with over 80% of “large farm” Schedule F forms.<sup>6</sup>

In 2004, about 80,000 Schedule F returns (4%) and 26,000 Forms 4835 (4%) were for households with more than \$200,000 AGI (the Administration’s proposed limit).<sup>7</sup> However, not all of these farms received government payments. About 25,000 Schedule F returns (1.2%) and 13,000 Forms 4835 (2%) both received payments and had AGI over \$200,000; these farms received about 5% of government payments.<sup>8</sup> These potentially affected farms are not necessarily large farms, nor above the AGI limit because of high *farm* income. More USDA and IRS data about partnerships and corporations is needed.

Texas A&M published a study of the proposal using representative farms.<sup>9</sup> 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 proposal say farmers are skilled at managing taxes and can keep taxable farm income lower than accounting measures of farm profitability.

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<sup>6</sup> 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>].

<sup>7</sup> CRS analysis of IRS data at [<http://www.irs.gov/taxstats/index.html>], Feb. 2007.

<sup>8</sup> USDA analysis of IRS data, unpublished, Feb. 2007.

<sup>9</sup> Agricultural and Food Policy Center, “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>].

**CBO Budget Options.** The Congressional Budget Office's 2007 edition of *Budget Options*<sup>10</sup> again proposes tighter payment limits to reduce agricultural spending. 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.

**Proposals in the 109<sup>th</sup> Congress.** Senator Grassley introduced S. 385 (109<sup>th</sup> Congress) to tighten limits on direct, counter-cyclical, and marketing loan payments to a total of \$250,000, and count commodity certificates and loan forfeiture toward marketing loan limits. The bill had eight cosponsors. An identical bill, H.R. 1590 (109<sup>th</sup> Congress), was introduced in the House by Representative Kind and had two cosponsors. Neither of the bills was formally considered by the agriculture committees, but they may be markers for bills to be introduced in the 110<sup>th</sup> Congress.

These bills would have reduced the statutory limit (before doubling) on direct payments from \$40,000 to \$20,000; and the limit on counter-cyclical payments would have decreased 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 been reduced because commodity certificates and loan forfeiture would be counted toward the limit (**Table 1**). This is a key feature 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 bills would have established 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 have continued. Thus, farmers would have had another means and found it easier to double the payment limits. The changes would have applied to the "covered commodities" and to certain loan commodities as a group, but peanuts, wool, mohair, and honey were not addressed by the bills.

In 2005, Congress debated farm bill changes as part of budget reconciliation for FY2006. Neither the House nor the Senate agriculture committee included payment limits in their reconciliation markup. But a floor amendment by Senator Grassley to add payment limits to the Senate version of the FY2006 budget reconciliation bill failed by a procedural vote of 46-53 on November 3, 2005 (S.Amdt. 2359 to S. 1932, 109<sup>th</sup> Congress). S.Amdt. 2359 contained the same monetary limits as S. 385 (109<sup>th</sup> Congress), but had different provisions regarding attribution and eligibility.

**Proposals in the 2002 Farm Bill and 108<sup>th</sup> Congress.** The Senate-passed version of the 2002 farm bill contained tighter limits (S.Amdt. 2826 to S. 1731, 107<sup>th</sup> Congress), but those limits were rejected by the conference committee. The vote on the Senate's 2002 farm bill amendment was 66-31 in favor of tighter limits. That bill would have limited direct and counter-cyclical payments to a combined \$75,000, allowed a \$50,000 spouse benefit, replaced the three-entity rule with direct attribution, limited marketing loan benefits to \$150,000, and counted commodity certificates and forfeiture. In 2003, Senator Grassley introduced a payment limits bill, S. 667 (108<sup>th</sup> Congress).

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