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# Effects of Reducing the Income Cap on Eligibility for Farm Program Payments

Ron L. Durst



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A Report from the Economic Research Service

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# Effects of Reducing the Income Cap on Eligibility for Farm Program Payments

**Ron L. Durst**

## Abstract

The current \$2.5-million income cap on eligibility for farm program payments affects only a small number of farm program payment recipients each year. A reduction in the cap to \$200,000 would affect a larger number of farm households but still only a small share of recipients. Based on IRS tax data for 2004, about 1.2 percent of all farm sole proprietors and about 2 percent of crop share landlords would be potentially subject to the proposed lower adjusted gross income (AGI) cap. ARMS survey data suggest a similar share of farm sole proprietors (1.1 percent) could be affected. When partnerships and farm corporations are included, about 1.5 percent of all farm operator households could be affected because a larger share of farm partnerships (2.5 percent) and farm corporations (9.7 percent) could be subject to the proposed cap. ARMS data indicate that \$807 million in payments were received in 2004 by farm operators organized as proprietors, partnerships, and corporations with incomes exceeding \$200,000. However, not all of these payments would be affected by a \$200,000 income cap on eligibility for payments due to differences in IRS and ARMS data and changes by producers in how they manage their incomes and expenses. The study also found that farm income averaged \$271,749 and net worth averaged over \$1.86 million for farm households with AGI estimated to be over \$200,000 based on the ARMS data.

**Keywords:** farm program payments, adjusted gross income, farm typology, tax data, AGI cap, farm households, Agricultural Resource Management Survey

## Contents

Summary .....	iii
Introduction .....	1
Data Sources .....	2
Farms With Payments and the AGI Cap on Eligibility .....	4
IRS Tax Data and the AGI Eligibility Cap .....	5
Share-Rent Landlords Potentially Subject to the AGI Cap .....	6
High-AGI Farm Households Vary Geographically .....	7
Comparing High-AGI Farm Households With Other Farm Households .....	8
Farm Organizations Affected Differently .....	9
Potential Effect on Farm Households Also Varies by Type of Farm ... ..	10
... and by Farm Commodity Produced .....	12
Effects of Eliminating the Farm Income Exception to the AGI Limit .....	13
Conclusions .....	14
References .....	15
Appendix—Estimating Adjusted Gross Income (AGI) from ARMS Data .....	16

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## Summary

Farm commodity program payment limits have been in effect since the Agricultural Act of 1970. However, these payment limits have not had much effect on the distribution of farm program payments. Only a small percentage of producers reach the current payment limit (\$360,000 per person) because of various legal and regulatory provisions available for avoiding the limits.

The Farm Security and Rural Investment Act of 2002 supplemented program payment limits with a cap on the income farmers can earn and still receive farm program payments. An individual or taxable entity with average AGI over \$2.5 million for the previous 3 tax years is ineligible for farm program payments. An exception applies to those with 75 percent or more of their average AGI from farming, ranching, or forestry operations. Thus, the cap only affects farm program participants with very high off-farm earnings both in absolute terms and relative to farm income. As a result, a substantial portion of program payments continue to go to large farms and high-income farm households.

### What Is the Issue?

To increase the effectiveness of farm program payment limits and reduce payments going to farmers with high incomes, the Administration's 2007 farm bill proposal would reduce the current \$2.5 million AGI eligibility cap to \$200,000 and eliminate the exception for those with 75 percent or more of their income from farming, ranching, or forestry. The proposed cap would apply only to farm commodity payments. This report investigates the share of payment recipients and program payments likely to be affected by the lowering of the AGI income cap.

### What Did the Study Find?

The current \$2.5-million cap on eligibility for farm program payments affects only a small number of farm program payment recipients each year. A reduction in the cap to \$200,000 and the elimination of the farm income exception would affect a larger number of farm households but still only a small share of government payment recipients. Based on Internal Revenue Service (IRS) tax data for 2004, about 1.2 percent of all farm sole proprietors and about 2 percent of crop share landlords would be potentially subject to the proposed lower AGI cap. Total government payments to these proprietors and landlords totaled \$399 million, or about 5 percent of farm program payments to all proprietors and share-rent landlords in 2004.

ARMS data suggest that a similar share of farm sole proprietors (1.1 percent) could be affected. When partnerships and farm corporations are included, about 1.5 percent of all farm operator households could be affected since a larger share of farm partnerships (2.5 percent) and farm corporations (9.7 percent) report income over \$200,000. ARMS data indicate that \$807 million in payments were received in 2004 by farm operators organized as proprietors, partnerships, and corporations with incomes



exceeding \$200,000. However, not all of these payments would be affected by a \$200,000 income cap on eligibility for payments due to differences in IRS and ARMS data and changes by producers in how they manage their incomes and expenses. The study also found that farm income averaged \$271,749 and net worth averaged over \$1.86 million for farm households with AGI estimated to be over \$200,000 based on the ARMS data.

The share of farm households potentially affected by the proposed lower cap would vary considerably by State. The share ranges from 1.5 percent for North Dakota to 13.4 percent for New Jersey. The Northeast and West report the highest share of farm returns with AGI over \$200,000, while the Corn Belt and Plains States report the lowest share.

## **How Was the Study Conducted?**

This report uses both published and special tabulation data obtained from the IRS to evaluate the proposed lower AGI cap on farm sole proprietors and crop-share landlords. It also uses ARMS farm-level data to estimate an AGI measure of income. The effects of the proposed lower cap on eligibility was evaluated by farm typology, farm commodity type, and organizational structure. The share of all government payments subject to the proposed limit was also estimated based on detailed government payment data from the ARMS survey.

## Introduction

Limits on the amount of annual payments a “person” can receive under certain farm commodity programs have been in effect since the Agricultural Act of 1970. The Farm Security and Rural Investment Act of 2002 also introduced a limit on payment eligibility based on income: an individual’s or entity’s average AGI cannot exceed \$2.5 million for the 3 tax years immediately preceding the applicable crop or program year. An exception applies if 75 percent or more of the average AGI is derived from farming, ranching, or forestry operations.

The effectiveness of these provisions is limited because farmers have been able to use various legal and regulatory provisions to avoid payment limits, and only a few farmers have income higher than the current AGI cap. As a result, a substantial share of program payments continue to go to large operations and high-income farmers (MacDonald et al., 2006). To increase the effectiveness of farm payment limits and to reduce payments going to farmers with high income, the Administration’s 2007 farm bill proposal would make a number of changes to existing payment limits and reduce the current \$2.5 million AGI eligibility cap to \$200,000 (USDA, 2007). The proposed lower cap would apply regardless of income source and thus would repeal the current exception for those with at least 75 percent of total income from farming, ranching, or forestry.

Under the Administration’s proposal, the new AGI cap would not apply to conservation and certain other government payments received by farmers. Four types of commodity payments—direct payments, countercyclical payments, loan deficiency payments, and marketing loan gains—would be subject to the cap. And these account for about two-thirds of all payments received by farm households.

This report uses Federal income tax data and USDA farm survey data to evaluate the potential impact of a reduced AGI cap on eligibility for farm program payments. These data illustrate how many payment recipients could be affected, the amount of payments they receive, how important these payments are to their economic well-being, and the characteristics and location of farm households potentially affected.

## Data Sources

The proposed income limitation is applied at the household level and is based on AGI. AGI is a tax-defined income measure that excludes a variety of tax-exempt income sources and includes various deductions, including for net operating losses (see box for a more complete description of AGI). Thus, AGI is not comparable to net farm income or farm operator household income. Because AGI is the relevant measure for eligibility purposes, actual tax data are the preferred source of information to assess the implications of lowering the income eligibility cap. This report uses both published and special tabulation data obtained from the IRS to evaluate the lower cap for farm sole proprietors and crop-share landlords.

While IRS tax data are clearly the preferred data source, data availability is a problem. Not all payments are reported as agricultural program payments on schedule F, the farm income and expense schedule. Some payments are reported on other forms or schedules and cannot be separately identified from available tax data. Farm program payment and other farm business

### What Is Adjusted Gross Income?

Adjusted gross income (AGI) is a measure of income defined for Federal income tax purposes. AGI is taxable income from all sources including wages, salaries, tips, taxable interest, ordinary dividends, taxable refunds, credits, or offsets of State and local income taxes, alimony received, business income or loss, capital gains or losses, other gains or losses, taxable IRA distributions, taxable pensions and annuities, rental real estate, royalties, farm income or losses, unemployment compensation, taxable social security benefits, and other taxable income. The business, rent, farm income, and similar components of AGI are net income measures after all expenses, including depreciation and capital expensing, associated with this income.

Another item that can have a significant impact on AGI is net operating losses (NOL). An NOL arises when allowed deductions exceed gross income for that year. A farmer with a substantial farm loss that exceeds other income could have an NOL. This NOL is not lost but can be carried back or forward for up to 20 years until used up against future income. Thus, a farm loss in the current year can have a negative effect on AGI in later years. The potential importance of the NOL issue is supported by tax data. There were about 97,000 farm sole proprietors that reported \$6.8 billion in net operating losses in 2000. This variability in farm income could greatly reduce the number of farm households that would be subject to the new cap. The farms most likely affected are those that have significant losses and little or no income from other sources to be offset by the farm losses (primary occupation farms).

From this measure of income, referred to as total income, there are certain adjustments and deductions allowed in determining AGI. The most significant deductions include those for individual retirement arrangements, medical savings accounts, one-half of self-employment tax paid, self-employed health insurance costs, and deductions for contributions to self-employed retirement plans.



information is also not generally available for farm partnerships and farm corporations. In addition, tax returns do not distinguish between farm program payments subject to the AGI limit and conservation or other payments that would not be subject to the limit. Finally, tax data provide little or no information on the types of commodities grown by high-AGI operators or the characteristics of their businesses and households.

To address these gaps, this report uses USDA's ARMS data to estimate an AGI measure (see Appendix). The effects of the proposed lower cap on eligibility can then be evaluated by farm typology, farm type, and organizational structure. The share of total government payments reported by operators with estimated AGI over \$200,000 can also be estimated because ARMS data provide information on the type of payment.

## About the Data

Both the current and the proposed AGI cap use a 3-year average to determine eligibility for farm program payments. Unfortunately, any analysis that uses IRS tax or ARMS survey data is restricted to a single year. Depending upon the farm household income situation for the applicable year, this could either overestimate or underestimate the impact of a limit based on a 3-year average. The analysis in this report is based on 2004 data. Farm household income for 2004 was well above the 5-year historical average, but was comparable to 2005 and slightly above forecasts for 2006.

In addition to income level, a variety of other factors suggest the estimates presented in this report should be considered an upper bound on both the number of farm operator households and the share of payments potentially affected by the proposed income cap on eligibility. The AGI limit is an all-or-nothing limit. Thus, exceeding the limit by only a small amount could trigger the loss of all program payments subject to the limit. This provides considerable incentive to manage income to avoid the loss of government payments. Most farmers use cash accounting and have options for either accelerating expenses or delaying income. They are also eligible for accelerated cost recovery of investments in farm machinery and equipment and a variety of self-employed retirement plans. AGI could be reduced by the full amount of a farm machinery or equipment purchase or by an additional contribution to a deductible retirement plan.

Some farmers may have the option to shift from payments covered by the AGI limit to those that are not subject to the AGI limit. This could include using the certificate exchange process to realize a certificate exchange gain rather than loan deficiency payments or marketing loan gains that are subject to the limit. The AGI of farmers with net operating losses can be reduced by a loss carryover from a prior year. While IRS AGI data reflect this in AGI for the current year, it is not possible to account for loss carryovers using ARMS data since the prior year's household income information is not available. Finally, for share-rent landlords and farms with multiple partners, farm program payments can often be redistributed away from households subject to the AGI cap. All of these actions could reduce the effect of the proposed lower income limit.

## Farms With Payments and the AGI Cap on Eligibility

Based on ARMS data, 40.2 percent of all farms received government payments in 2004. The average payment for farms with payments was \$12,034. On average, these payments represent 11.2 percent of the gross cash farm income of those farm households receiving payments.

According to IRS data, only about 3,084, or 0.15 percent, of all farm sole proprietors reported AGI over \$2.5 million in 2004. Since not all of these received commodity program payments, many qualify for the 75-percent farm income exception, and year-to-year income variability would reduce the 3-year average AGI of others, it is unlikely that the current cap affects more than a few hundred proprietors each year.

The proposed reduction in the cap would affect a larger share of program payment recipients. In discussing the new proposed cap, USDA has cited 2003 IRS tax data that suggest about 3.6 percent of all farm sole proprietors had AGI over \$200,000 in 2003.<sup>1</sup> This group received about 4.5 percent of all farm program and conservation payments.

More recently, Texas A&M University published a study of the proposal using representative farms (Agriculture and Food Policy Center, 2007). This study concluded that more farms may be affected than IRS data suggest. However, a Congressional Research Service report (2007) reviewing the Texas A&M study suggests that “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.” AGI is the relevant measure for eligibility purposes and is a tax-defined measure that is not the same as net farm income or farm household income, especially when significant farm losses are present. Thus, actual tax data are the best source of information to assess the implications of lowering the income eligibility cap.

<sup>1</sup>This represents all farm sole proprietors with AGI over \$200,000 since the share of these returns with payments was not separately identified for 2003.

## IRS Tax Data and the AGI Eligibility Cap

IRS data are the most comprehensive tax data for farm sole proprietorships. In 2004, 1.2 percent of farm sole proprietors received farm program and conservation payments and had AGI over \$200,000 (table 1). These farmers reported average payments of \$13,052 for a total of \$328.8 million in payments. This represented about 4.7 percent of farm program and conservation payments received by all farm sole proprietors in 2004.

Table 1

### Farm sole proprietors and share-rent landlords with adjusted gross income (AGI) over \$200,000 in 2004

	All farm proprietors/landlords			Proprietors/landlords AGI > \$200,000		Proprietors/landlords with AGI > \$200,000 receiving program payments				
	Number	Total program payments (\$1,000)	Average payments (dollars)	Number	Percent	Number	Percent	Total program payments (\$1,000)	Average payments (dollars)	Share total payments
Proprietors	2,022,298	7,023,497	3,473	84,932	4.2	25,191	1.2	328,794	13,052	4.7
Share landlords	638,394	1,184,048	1,855	29,407	4.6	12,906	2.0	70,081	5,430	5.9
Total	2,660,692	8,207,545	3,085	114,339	4.3	38,097	1.4	398,875	10,470	4.9

Note: Total program payments include conservation and other payments that are not subject to the proposed \$200,000 AGI cap but that cannot be identified separately.

Source: Special tabulations from Internal Revenue Service (IRS), Statistics of Income Division, February 2007.

## **Share-Rent Landlords Potentially Subject to the AGI Cap**

Landowners who do not materially participate in the operation or management of the farm and report farm rental income based on crops or livestock produced by a tenant (share-rent landlords) are eligible to receive farm program payments but are not considered farm sole proprietors for Federal tax purposes. In 2004, 638,394 share-rent landlords received over \$1 billion in farm program and conservation payments (table 1).

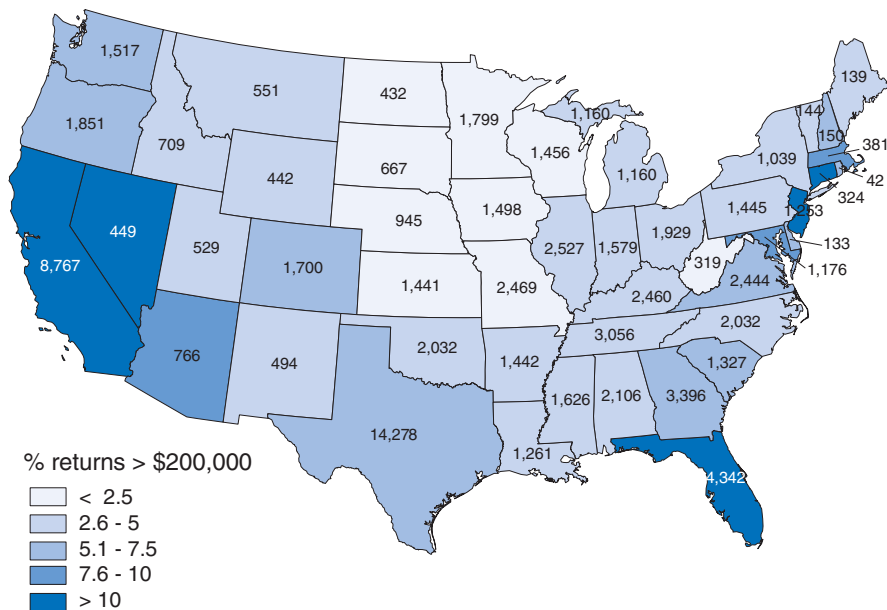
About 2 percent of these share-rent landlords received some farm program and conservation payments and reported AGI over \$200,000. These landlords received an average of \$5,430 in payments for a total of \$70.1 million. This represented 5.9 percent of the farm program payments received by share-rent landlords. However, the amount of payments actually affected by the proposed cap could be well below the potential \$70.1 million, since landlords would not lose conservation payments and could change to a cash lease, shifting program payments to the tenant operator.

## High-AGI Farm Households Vary Geographically

The impact from reducing the AGI payment cap may vary regionally. The number and share of farm sole proprietorship returns with AGI over \$200,000 as reported in 2004 tax returns reveals considerable variation in the distribution of high-AGI households across States. The share ranges from 1.5 percent of farm sole proprietors in North Dakota to 13.4 percent in New Jersey.

The Northeast and West have the largest share of farm returns with AGI over \$200,000, while the Corn Belt and Plains States report the lowest (fig. 1). Just four States—California, Texas, Florida, and Georgia—account for over one-third of all farm sole proprietors with AGI high enough to be potentially affected by the proposed cap.

Figure 1  
**Number and share of farm sole proprietorship returns with adjusted gross income over \$200,000 by State, 2004**



Note: The number and share of returns represent all returns with over \$200,000 since those with payments cannot be separately identified at the State level.

Source: Compiled by Economic Research Service from Internal Revenue Service, Statistics of Income Division tax data.

## Comparing High-AGI Farm Households With Other Farm Households

Based on 2004 ARMS data, an estimated 1.46 percent of farm operator households had AGI over \$200,000 and received some farm program payments (table 2). The average payment for these farms was \$26,732. The average payment for all other farms was only \$2,770.

Households with commodity payments and estimated AGI over \$200,000 differ markedly from all other farm households with regard to farm size, farm and household income, and net worth. These high-AGI farm households had average farm business receipts over nine times the amount for all other farm operator households. Farm income averaged \$271,749, versus an average of \$8,803 for all others, while both average net worth and off-farm income were about three times those of all other farm households.

Table 2

### Farm operator households with AGI above \$200,000 that receive farm commodity payments versus all other farm operator households, 2004

	Farm households AGI > \$200,000 with commodity payments <sup>1</sup>	All other farm households
Number	30,206	2,037,167
Percent	1.46	98.54
Total farm commodity payments (\$ million)	807.5	5,642.9
Percent	12.5	87.5
Average commodity payments (\$)	26,732	2,770
Average gross farm income	730,799	80,680
Average net farm income	271,749	8,803
Average off- farm income	194,111	66,688
Average total household income	465,860	75,491
Average net worth	1,859,857	627,797

<sup>1</sup>Includes only those program payments covered by AGI limit.

Source: Estimated from Agricultural Resource Management Survey data, 2004



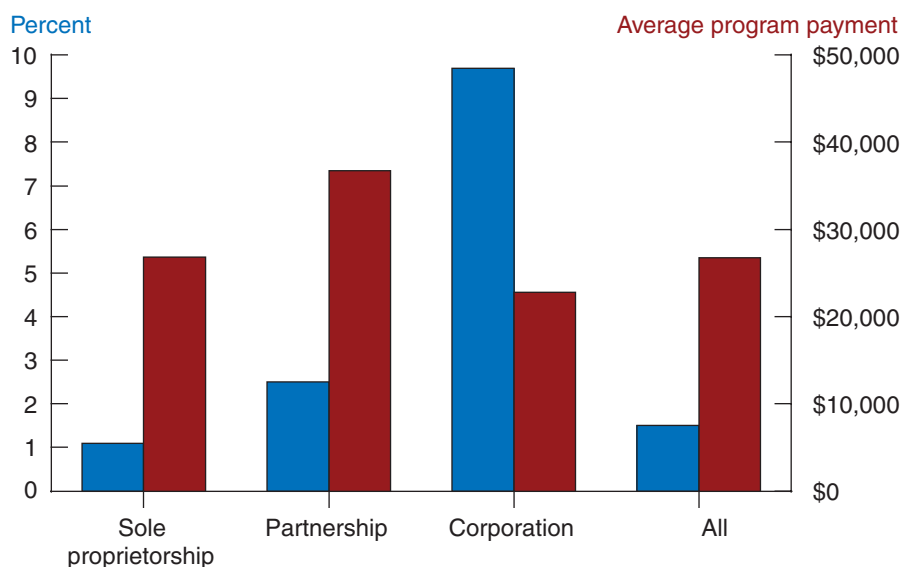
## Farm Organizations Affected Differently

While only about 1.5 percent of all farm operator households were estimated to have AGI over \$200,000, there is considerable variation by organizational structure. Only about 1.1 percent of farm sole proprietorships report AGI over \$200,000, while about 2.5 percent of farm partnerships and 9.7 percent of farm households involved in farming through a corporation reported AGI over \$200,000 (fig. 2).

Farm partnerships reported the highest average payments at \$36,736, versus \$26,862 for sole proprietorships and \$22,764 for farm corporations (table 3). Partnerships were also much larger with average farm business receipts of about \$2.15 million, more than four times that of sole proprietorships and nearly three times that of corporations.

Figure 2

### Share and average payment for farm operators with adjusted gross income over \$200,000 by type of organization



<sup>1</sup>Includes only those program payments covered by the AGI eligibility cap.

Source: Estimated from Agricultural Resource Management Survey data, 2004.

Table 3

### Share of program payments and farm business receipts for operators with AGI over \$200,000 and payments by type of organization in 2004

Type of organization	All farm operators			Farm operators with AGI > \$200,000 receiving program payments						
	Number	Total program payments (\$million) <sup>1</sup>	Average payments (dollars)	Number	Percent	Total program payments (\$million) <sup>1</sup>	Average payments (dollars)	Percent of total payments	Total farm receipts (\$million)	Percent of total receipts
Proprietors	1,903,151	5,081.4	2,670	21,161	1.1	568.4	26,862	11.2	11,721	9.8
Partnerships	95,331	778.1	8,162	2,372	2.5	87.1	36,736	11.2	5,095	16.2
Corporations	68,891	589.7	8,560	6,674	9.7	151.9	22,764	25.8	5,259	15.1
Total	2,067,373	6,450.5	3,120	30,207	1.5	807.5	26,732	12.5	22,075	11.8

<sup>1</sup>Includes only those program payments covered by AGI limit.

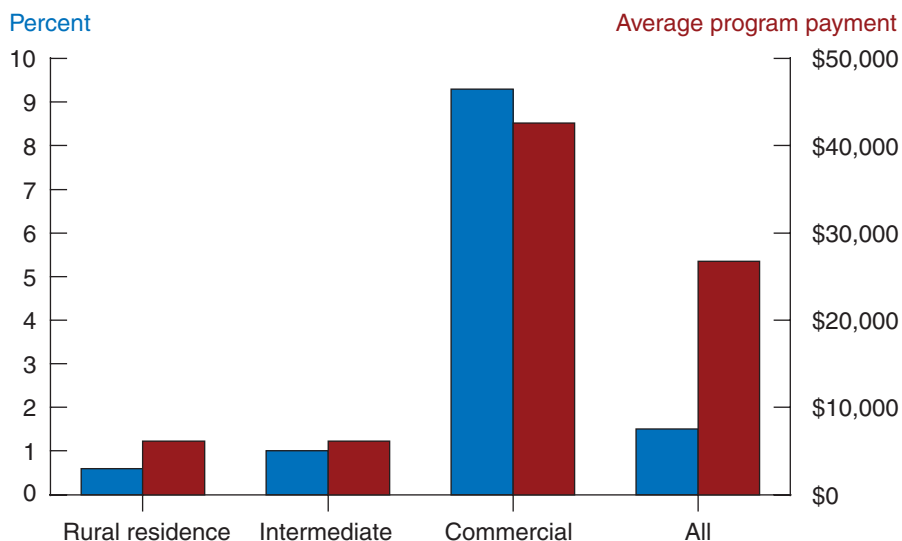
Source: Estimated from Agricultural Resource Management Survey data, 2004.

## Potential Effect on Farm Households Also Varies by Type of Farm ...

Slightly less than 9 percent of all farms are classified as commercial farms (see typology box). Nevertheless, these farms account for over half of all farm households and 90 percent of all payments reported by those with estimated AGI over \$200,000. Nearly 1 out of every 10 commercial farms with payments reported AGI over \$200,000 in 2004, versus less than 1 percent for intermediate farms and 0.6 percent for rural residence farms (fig. 3). Average payments for commercial farms were also significantly higher at \$42,579, compared with a combined average of \$6,123 for intermediate and rural residence farms.

Figure 3

### Share and average payment for farm operators with adjusted gross income over \$200,000 by farm typology



<sup>1</sup>Includes only those program payments covered by the AGI eligibility cap. <sup>2</sup>Average payment amounts for rural residence and intermediate is a combined average.

Source: Estimated from Agricultural Resource Management Survey data, 2004.

## Collapsed Farm Typology

The collapsed farm typology combines the eight farm typology groups into three categories:

### Rural-residence farms:

- *Limited-resource farms.* Small farms with low household income and gross sales less than \$105,000 in 2004. Household income is considered low in a given year if it is less than the poverty level for a family of four, or less than half the county median household income. Operators may report any major occupation except hired manager.
- *Retirement farms.* Small farms whose operators report they are retired.
- *Residential/lifestyle farms.* Small farms whose operators report a major occupation other than farming.

### Intermediate farms:

- *Farming-occupation farms.* Small family farms whose operators report farming as their major occupation.  
*Low-sales farms.* Gross sales less than \$100,000.  
*High-sales farms.* Gross sales between \$100,000 and \$249,999.

### Commercial farms:

- Large family farms. Gross sales between \$250,000 and \$499,999.
- Very large family farms. Gross sales of \$500,000 or more.

## **... and by Farm Commodity Produced**

A larger share of crop than livestock farms received payments and had AGI over \$200,000 in 2004. However, many livestock farms also produce program crops. In 2004, about 2.2 percent of all crop farms had estimated AGI over \$200,000, versus 1 percent of all livestock farms. High-AGI crop farms also reported higher average payments (\$32,615) than high-AGI livestock farms (\$16,416). However, high-AGI livestock farms were larger and had a higher average household income and net worth. Thus, payments are a much larger share of farm household income for high-AGI crop farms than for similarly situated livestock operations.

Of crop farms, rice and cotton farms are the most likely to be subject to the proposed cap, with 8.5 percent and 9.3 percent of rice and cotton farms receiving program payments and having an AGI over \$200,000. This compares to 5.5 percent for corn farms and only 1.3 percent for soybean farms. Average payments for these farms were also well above the average for all other farms with estimated AGI over \$200,000. Among livestock farms, hog farms were the most likely to be subject to the cap with 6.4 percent reporting payments and adjusted gross income over \$200,000.

## **Effects of Eliminating the Farm Income Exception to the AGI Limit**

The elimination of the farm income exception to the AGI limit is an important part of the Administration's proposal. Since ARMS data provide information on both farm and total income, it is possible to estimate the impact of eliminating the exception to the AGI cap for farms with 75 percent or more of total income from farming and ranching. Based on ARMS data, about 40 percent of all farm operator households with payments and AGI over \$200,000 could qualify for the exception. A large share of those eligible would be farm households associated with commercial farming operations. In fact, nearly 3 out of every 4 commercial farms would be eligible for the exception. In contrast, only about 5 percent of rural residence and intermediate farm households would qualify for a farm income exception. Rural residence and intermediate farms receive most of their income from nonfarm sources, and many actually report a loss from farming.

## Conclusions

The current \$2.5-million cap on eligibility for farm program payments affects only a small number of recipients each year. A reduction in the cap to \$200,000 and elimination of the exception for those with at least 75 percent of total income from farming would still affect only a relatively small share of program payment recipients.

Based on IRS tax data for 2004, about 1.2 percent of all farm sole proprietors could be subject to the proposed lower AGI cap. ARMS data suggest a share of about 1.1 percent. While IRS data are not available for farm partnerships and corporations, ARMS data suggest a larger share of farm partnerships (2.5 percent) and farm corporations (9.7 percent) could be subject to the proposed lower cap. Thus, based on 2004 data, about 1.5 percent of U.S. farm operator households could be affected by the Administration's proposed AGI cap. ARMS data indicate that \$807 million in payments were received in 2004 by farm operators organized as proprietors, partnerships, and corporations with incomes exceeding \$200,000. However, not all of these payments would be affected by a \$200,000 income cap on eligibility for payments due to differences in IRS and ARMS data and changes by producers in how they manage their incomes and expenses.

Some farm landlords are also eligible to receive payments. According to IRS tax returns, a slightly larger share of crop-share landlords than farm sole proprietors would be potentially subject to the lower cap. However, these landlords received only about \$70 million in farm program and conservation payments in 2004, and they could shift payments to tenants if they were affected by the proposed cap.

The share of farm households potentially affected by the proposed lower cap varies widely by region. The share of farms with high AGI ranges from 1.5 percent for North Dakota to 13.4 percent for New Jersey. The Northeast and West have the highest share of farm returns with AGI over \$200,000, while the Corn Belt and Plains States report the lowest share.

Finally, for most of the farm households with program payments and estimated AGI over \$200,000, farm program payments do not represent a substantial share of total household income. While average payments for farm households with AGI above the proposed cap were estimated at \$26,732 for 2004, their total household income averaged \$465,860.



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## **Appendix 1—Estimating Adjusted Gross Income (AGI) from ARMS Data**

Adjusted gross income (AGI) is a measure of income defined for Federal income tax purposes. However, the Agricultural Resource Management Survey (ARMS) contains information on farm and off-farm sources of income as well as other operator characteristics that allows a comparable measure of income to be estimated from survey data.

Most farmers utilize the cash method of accounting for tax purposes. The ARMS data contains information on cash receipts from livestock, crops, government payments and other farm related income. These items are combined to provide an estimate of cash farm business income.

Farm expenses are also reported on a cash basis. ARMS collects information on all major farm business expenses. In addition to cash expenses, farmers are allowed to claim a deduction for depreciation of farm machinery, equipment and other depreciable property. The ARMS data also provide an estimate of tax depreciation for the year. These cash and noncash expenses are subtracted from farm business income to estimate net cash farm business income. In some instances, other items may be subtracted including farm rental income and income and payments to other households. The result is an estimate of farm net profit or loss reported on the farm income tax return.

Adjusted gross income includes income from all sources. With the exception of net operating losses that are carried over from a prior year, ARMS data provides information for off-farm income sources for both the operator and the operator's spouse. These income sources, including capital gains, are added to farm net income/loss to estimate total income. The final step in estimating adjusted gross income is to reduce total income by certain adjustments to income. The most important adjustments for farmers are those for self-employed health insurance costs, one-half self-employment taxes and contributions to retirement plans. These adjustments are subtracted from total income to estimate the adjusted gross income measure for the farm operator household.