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## Overview

The 2008 Farm Bill<sup>1</sup> and subsequent regulations have established new adjusted gross income (AGI) and adjusted gross farm income (AGFI) limitations for program eligibility.<sup>2</sup> The new limitations are considerably lower than the previous limitation of \$2,500,000 and could have application to more producers than did the limitation under prior law. As a result, the correct computation of AGI and AGFI can be critical for ensuring that a producer remains eligible for farm program payments.

## Income Limitation Rules

The new income limitations are effective beginning with the 2009 crop year.<sup>3</sup> For commodity and price support programs, a producer must have non-farm AGI of \$500,000 or less to be eligible for Direct and Counter-Cyclical Program (DCP) payments or price support benefits, and AGFI of \$750,000 or less to be eligible for direct payments under the DCP.<sup>4</sup> For conservation program benefits, the adjusted gross non-farm income limit is \$1 million *unless* two-thirds of AGI (both farm and non-farm) is derived from farming, ranching and forestry operations.<sup>5</sup> The 2008 Farm Bill also expands the definition of average AGI derived from farming, ranching and forestry to include income and benefits from the production of all types of livestock, farm-based renewable energy, and the processing,

packing, storing, shedding, and transporting of farm, ranch, and forestry commodities (including renewable energy). In addition, the Bill gives the Ag Secretary the discretion to include the income from any additional activity related to farming, ranching or forestry.

**Note:** The income from the sale of equipment used to conduct farm, ranch or forestry operations, and income from the provision of production inputs and services to farmers, ranchers, foresters and farm operations is included as farm income if two-thirds or more of the individual or entity’s AGI is farm income.

The calculation of “average AGI” is computed over “an applicable three year period.” For the 2009 program year, the three-year period involves tax years 2005, 2006 and 2007.

**Note:** Annual certifications of AGI compliance are required from each individual and legal entity<sup>6</sup> that requests CCC payments either directly or indirectly. The certifications can be made either on Form CCC-926, or by providing FSA with an acceptable statement from a CPA or attorney.<sup>7</sup>

## Key Definitions

USDA regulations define AGI as “adjusted gross income as defined under I.R.C. §62.”<sup>8</sup> For tax purposes, I.R.C. §62, is defined as gross income minus trade and business deductions and other various deductions. In essence, AGI is a producer’s “net income” less some “above the line” deductions on the front of the producer’s Form 1040. Thus, AGI is the amount that is reported on line 37 of Form 1040.

The definition of AGFI is less straightforward. For tax purposes, “gross farm income” is the producer’s gross income or gross revenue attributed to the taxpayer. However, the FSA’s concept of AGFI is different. For FSA purposes, AGFI is the “net income” from farming and related operations. Indeed, the USDA regulation defining AGFI states that AGFI is the “portion of the AGI of the person or legal entity that is attributable to farming, ranching...”<sup>9</sup> Therefore, since AGI is clearly defined as net profit in accordance with I.R.C. §62, the portion of AGI that is AGFI must also be net profit.<sup>10</sup>

## Determining AGFI

Determining AGFI is not as simple as referring to the number on line 18 of Form 1040 (farm income or loss). Instead, AGFI is net farm income on line 18 of Form 1040 *plus* any additional income from the sale of such items as agricultural related land, breeding livestock, agricultural/conservation easements and farm related machinery.<sup>11</sup> These additional sources of income are generally reported on Schedule D, Form 4797 or Schedule E (for royalty income, real estate rental income and pass-through income from an entity) and on Form 1040, lines 13, 14, and/or 17.

Therefore, the determination of a farmer’s AGFI begins with net farm income reported on line 18 of Form 1040 plus farm related income on lines 13, 14, and/or 17. From that total the amount of any “above the line” deductions attributed to this income is subtracted. The result is AGFI.

**Observation:** A producer may need the assistance of a tax professional in determining AGFI.

## Reporting AGI and AGFI to FSA

For farm program eligibility determination purposes, a producer must report their 3-year average AGI and AGFI to FSA on form CCC-926. Page three of the Form CCC-926 provides guidance on determining adjusted gross income and states that “for persons that file the IRS Form 1040, specific lines on that form represent the adjusted gross income and the income from farming, ranching or forestry operations.” The instructions then tell the producer to find compute AGI and AGFI from specified lines on IRS Form 1040 – which are net income amounts.

## AGFI as a “Net” Concept

Clearly, AGFI is a “net income” concept – it is not a producer’s gross farm revenue. It is the producer’s net farm income. If a producer were to report gross farm income instead of their net farm income, the producer could mistakenly believe that they are ineligible for program payments.

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**Example:** Guy Wire has a 3-year average AGFI over \$750,000 and is ineligible for direct payments. Guy produces soybeans on 1,000 acres and corn on an additional 640 acres. For 2005-2007, Guy’s soybean crop yielded an average of 50 bushels per acre

and he received an average of \$9.00 per bushel. Thus, Guy's gross farm income solely from the bean crop averaged each year \$450,000. Over the same timeframe, Guy's corn crop yielded an average of 225 bushels per acre and he received an average of \$4.00 per bushel. Thus, Guy's gross farm income solely from the corn crop averaged \$576,000, and his gross farm income from both crops combined averaged \$1,026,000. If Guy uses his gross farm income for purposes of the CCC-926, he would be ineligible for direct payments. To properly determine his eligibility for DCP or price support payments, Guy must take care to reduce his gross income amounts by any above-the-line deductions attributed to his farm income.

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## Summary

The new AGI and AGFI definitions and the lower dollar limit for program eligibility contained in the 2008 Farm Bill require care on the part of producers to make sure that income amounts are reported properly. In some situations, it may be necessary for a producer to retain tax counsel to ensure the proper calculation of income amounts for payment limitation purposes.

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<sup>1</sup> Pub. Law. No. 110-234.

<sup>2</sup> See 7 U.S.C. §1308-3a(e).

<sup>3</sup> The applicable payment limitation on direct payments for crop years 2008-2012 for a person or entity (whether received directly or indirectly) is \$40,000. The payment limit will be adjusted for participation in the ACRE program in years 2009-2012. 7 U.S.C. §1308. The counter-cyclical payment limit amount is \$65,000 for crop years 2008-2012, and will be adjusted if the recipient participates in the

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ACRE program in years 2009-2012. 7 U.S.C. §7991(d).

<sup>4</sup> These limits also apply to disaster assistance programs and the Milk Income Loss Compensation Program.

<sup>5</sup> 7 U.S.C. §1308-3a(e). This limitation can be waived on a case-by-case basis for environmentally sensitive land of special significance

<sup>6</sup> For pass-through entities, AGI certifications are required from each member who is an individual or entity, and from each embedded interest holder. For other entities, the entity each interest holder in the entity with a direct or indirect interest must provide an annual AGI certification.

<sup>7</sup> Compliance with the AGI rules will be tracked through four levels of ownership in an entity. Any noncompliance within those levels will result in payment being reduced by an amount that is commensurate with the ineligible share.

<sup>8</sup> 7 C.F.R. §1400.3

<sup>9</sup> *Id.*

<sup>10</sup> The instructions to FSA Form CCC-926 confirm that both AGI and AGFI are a "net income" concept.

<sup>11</sup> See FSA Notice PL-185 for an expansive list of income sources. Importantly, Notice PL-185 does *not* list wages or dividends received by a shareholder of a C corporation.