

February 17, 2010

- Robert E. Moore\* and Roger A. McEowen\*\*

## Overview

In early January, 2010, the United States Department of Agriculture published a final rule for farm program payment eligibility and payment limitation requirements for 2010 and later crop years.<sup>1</sup> The final rule makes several changes to the interim rule with a key change involving an exception for contributions by members of entities. That change has implications for farming operations structured as multiple entities.<sup>2</sup>

## FSA Rule on Inactive Members

The FSA Payment Limitation Handbook (4-PL) that resulted from the 2008 Farm Bill was contradictory in its treatment of inactive members of entities.<sup>3</sup> Paragraph 147 of the 4-PL stated that all persons having an ownership interest in a business entity must contribute commensurate labor and/or management. However, Paragraph 148 provided an example of a co-owner of an entity not contributing labor or management. FSA concluded that the entity remained eligible for payments, but payments were to be reduced in proportion to the non-active owner's share of ownership. The two paragraphs in the Payment Limitation Handbook were clearly in conflict.

FSA resolved this conflict in Notice PL-203.<sup>4</sup> The rule is retained that all persons with an ownership interest in an entity must contribute active personal management and/or active personal labor to the entity. A payment reduction will be applied to an entity with owners that fail to provide active personal management and/or active personal labor.

The reduction in payments will be in proportion to the inactive owner(s)' ownership.

**Example:** ABC Farms, LLC is owned equally by Mother, Father, Daughter, and Son. Mother, Father, and Daughter operate the farm and contribute labor and management. Son works off the farm and provides no labor or management. The entity's program payments will be reduced by 25% to account for the son's lack of labor and/or management contribution to the farming operation.

FSA has created an exception that, for 2010 payment eligibility determination purposes, allows an entity that has inactive members to receive full program payments. Under the exception, at least 50 percent of the entity must be owned by persons providing active personal labor and/or active personal management to the farming operation. Additionally, the entity's members must collectively receive (either directly or indirectly) total direct payments under the DCP program that are less than or equal to a single payment limitation. So, if the entity and the owners of the entity do not receive, in total, more than \$40,000, the entity may still receive full payments.<sup>5</sup>

**Example:** Assume that ABC Farms, LLC receives \$40,000 in payments and the four owners *do not* collect direct payments from other sources. Therefore, ABC Farms LLC can receive all \$40,000 of direct payments for which it is eligible.

In multiple entity settings, however, the exception may not apply.

**Example:** Assume that with respect to ABC Farms, LLC, Mother and Father are also involved in another farming operation where they receive \$7,500 each in direct payments. Thus, between the \$40,000 payment attributed to ABC Farms, LLC, and the \$15,000 attributed to Mother and Father, \$55,000, could be received collectively. In this situation, ABC Farms, LLC is not eligible for the exemption and will only be eligible for 75 percent of Direct payments (due to the Son's inactivity in the business – the Son is a 25 percent shareholder).

## Conclusion

This new ruling will affect those producers who are farming with multiple operations, one of which is an entity with at least one inactive owner. To avoid a reduction in payments due to an inactive owner, the active owners will need to buy out the inactive owner or replace the inactive owner with an active owner. If either of these two strategies are considered, a tax professional should be consulted to determine what tax liability, if any, will result from removing the inactive member.

---

<sup>4</sup> 75 Fed. Reg. 887-900, Sec. 1400.204. PL-203 was updated and obsoleted by PL-204 (Jan. 26, 2010).

<sup>5</sup> Producers participating in ACRE will have a Direct Payment Limitation of \$32,000.

---

\*Attorney-at-law, Wright Law Co., LPA, Dublin, OH  
\*\*Leonard Dolezal Professor in Agricultural Law, Iowa State University, Ames, Iowa, and Director of the ISU Center for Agricultural Law and Taxation. Member of the Iowa and Kansas Bar Associations and licensed to practice in Nebraska.

<sup>1</sup> USDA Notice PL-203. The Notice is published at 75 Fed. Reg. 887-900 in Sec. 1400.204. The Notice amends a previous interim rule that was published on December 29, 2008. 73 Fed. Reg. 79267-79284 (implementing payment eligibility and payment limitation provisions of the Food, Conservation, and Energy Act of 2008).

<sup>2</sup> PL-203 was updated and obsoleted by PL-204 (Jan. 26, 2010).

<sup>3</sup> Entities include corporations, LLC's, and limited partnerships. Entities do not include general partnerships or joint ventures.