Inflation Reduction Act: Farm Loan Relief Program Payment

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Rural Tax Education

• Website hosted by Utah State University
• Material developed, managed, and owned by the National Farm Income Tax Committee
• Informational Material on Ag, Timber, and Rural Tax topics include but not limited to:
  • Disaster/Weather Losses
  • Treatment of Government Payments
  • Farm Losses and Hobby Rules
  • Self-Employment Taxes
  • Estate and Gift Taxes
  • Like Kind Exchanges
  • Depreciation
  • Etc...

RuralTax.org

info@RuralTax.org
RuralTax.org
Resources

- RuralTax.org landing page
- Information including topics such as:
  - Farm Loan Immediate Relief for Borrowers with At-Risk Agricultural Operations
- Webinars, useful links, and other resources

IRA Assistance for Distressed Borrowers
extension.usu.edu/ruraltax/ira-distress
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Program Agenda

• Inflation Reduction Act (IRA) Assistance for Distressed Borrowers

• Characteristics of Income

• Challenges

• Tax Management Strategies
IRA Assistance for Distressed Borrowers
IRA Assistance for Distressed Borrowers

• Program developed by the IRA, Aug. 2022

• FSA has identified recipients eligible for program payments.

• Payments are automatic

• The payment is subject to income & SE taxes

• In addition to federal tax liability, individuals may also have a state and local tax liability, as well as other tax implications
Eligibility

• This is **NOT**:  
  • Debt Relief.  
  • Cancellation of Debt.  

• This **IS**:  
  • This is an Ad Hoc Government Program Payment.  

• **WHY?**  
  • Any debt relief or cancellation of debt on a government loan will immediately end the potential future eligibility for several the more common federal programs and loans.
How Does This Work?

- USDA – FSA has already identified eligible participants and has already begun to make Program Payments.
- Direct Loan Borrowers of USDA FSA Loans
  - The program payments for direct loan borrowers were directly applied to the loans to make the borrower “current”.
  - An additional amount was also paid to cover the next upcoming loan payment.
- Guaranteed Loans through a commercial lender
  - Have also been sent out with the name of the commercial bank and the borrower to be applied to the loan.
  - If the bank chooses not to apply the payment to the loan and releases the check to the borrower, the program payment value will no longer be “guaranteed” if the loan goes into default.
- Disaster Set-Aside Program
  - The amount that was set-aside will be directly applied to what was set-aside
Characteristics of Income

• The program payment is ordinary income subject to Self-Employment Tax.
• The borrower should receive a 1099-G (if $600 or above) and a 1098 which will show the interest that has been paid by the borrower.
  • The interest portion paid is a deductible cash expense to the farming operation & will help offset the income from the program payment dollar for dollar that was applied to the interest portion of the debt payment.
• Please work with the borrowers that may be clients of yours with potential tax management strategies.
• Payments are averaging from $80,000 - $150,000.
  • Some may be very small, while others may be much much higher.
Challenges

• Phantom Cash!
  • A payment is received without any cash directly flowing through the borrower/operation; therefore, no cash can be pulled to cover the tax liability of the income.

• Potential negative effects on other benefits.
  • Affordable Care Act
  • Social Security
  • Medicare and Medicaid
  • EXAMPLE: 80-year-old woman living in a nursing home and has not farmed in over 20 years, but still has debt from a direct USDA FSA loan. She is on Medicare, Medicaid, and receiving Social Security that has money being taken out of her check to cover the remaining debt.
  • She now receives a sizable program payment that pays off the remaining debt!
IRA Assistance Program

• You do not have to sign-up for the program payment, the USDA FSA has already identified those individuals that are eligible.
• Borrowers that have received program benefits will receive a letter from the USDA FSA stating either that a program payment was made and was directly applied to the loan, or receive a check made out to them and the lender to apply to the loan.
• The borrower will also receive a 1099-G and possibly a 1098 from the USDA FSA for the year.
Tax Management and Planning
Tax Management

• Given the situation, there may be Net Operating Losses (NOL’s). That may be able to be carried forward to offset some of the debt.
• If any capital assets have been purchased utilization of Section 179 or Bonus depreciation. Please be careful as overusing this may create tax issues in the future.
• If cash/working capital is available, consider the purchase of some Pre-Pays if appropriate.
• Use of Income Averaging (Schedule J)
Tax Management Methods

• Tax Management
  • Prepaying Deductible Expenses
  • Depreciation
  • Net Operation Loss
  • Income Averaging (Schedule J)
  • Deferral of Income
  • Crop and/or Livestock sales
  • Accelerated Depreciation
    • Section 179 and Bonus
  • Crop Insurance Deferral
  • Net Operating Loss (Carry forwards)
• Farm Financial Management
Tax Planning Strategies

• Pre-Pay Expenses
• Income Averaging
• Deferral of Income
  • Crop and/or Livestock sales
• Accelerated Depreciation
  • Section 179 and Bonus
• Crop Insurance Deferral
• Net Operating Loss (Carry forwards)

Source: Rob Holcomb, University of Minnesota
Prepaying expenses

• Cash basis deduction generally limited if useful life beyond end of tax year

• 12-month rule provides an exception if benefits do not extend beyond the earlier of
  • 12 months after the benefit begins, or
  • the end of the following tax year

• Example: One-year insurance premium paid in November is okay

• Planning Note - No prepaid interest, only what has accrued to year-end since last payment

Source: Rob Holcomb, University of Minnesota
Prepaid farm supplies exception and limit

- Prepaid farm supplies may still be limited to 50% of all other expenses
  - Unused due to fire, storm, flood, etc. is not counted
- Limit doesn’t apply to taxpayer who
  - Is a *farm-related taxpayer and*
  - Has total prepaid farm supplies for the preceding 3 years of less than 50% of all other expenses *or*
  - Exceeds limit due to unusual change in business operations

Source: Rob Holcomb, University of Minnesota
Prepaid farm supplies

3-part test for prepaid expense deduction

1. **Payment, not deposit**
   - Facts and circumstances
   - Constructive Receipt
     - Must specify the product(s), quantity, and the exact price

2. **Valid business purpose**
   - Fixing price and supply

3. **No material distortion of income**
   ➢ Remember other expenses!

Source: Rob Holcomb, University of Minnesota
Income Averaging

- Filed on Schedule J
- Allows taxpayers to utilize unused tax brackets from previous 3 years

Source: Rob Holcomb, University of Minnesota
Income Averaging

• Only farm income qualifies
• Does not affect:
  • Self-employment income or tax
  • Taxable income

Source: Rob Holcomb, University of Minnesota
Income Averaging

Source: Rob Holcomb, University of Minnesota
Defer Crop and Livestock Sales

- Postpone sales into next year. Income is taxable upon receipt.
  - Constructive receipt rules
- Transfer of ownership and telling the buyer to hold the check does not work. Must do a deferred payment contract (next slide).

Source: Rob Holcomb, University of Minnesota
Deferred Sales (Deferred Sales Contract)

- Allowed under installment sale rules
- Producer must have binding contract with buyer
- No constructive receipt of income
- Seller is an unsecured creditor

**Risk**
- If the buyer or seller goes out of business before payment

Source: Rob Holcomb, University of Minnesota
Weather-Related Provisions for Livestock Sales

• Sales of animals due to weather-related conditions
• Shortage of feed or water
• Draft, dairy, and breeding animals
• Not sport or poultry
• Postpone gain to avoid bunching of income
• Sales in excess of normal practice

Source: Rob Holcomb, University of Minnesota
Weather-Related Sales of Livestock

• Breeding Stock
  • If sold due to weather-related conditions, the gain is postponed for up to two years providing the producers replace the animals.
  • Replacement animals must be like-kind.
  • Deferral amount is based on the number of head above the normal cull rate.
  • Replacement period may be extended if weather conditions persist.
  • No disaster declaration is required.

Source: Rob Holcomb, University of Minnesota
Weather-Related Sales of Livestock

• Animals Raised for Sale
  • Weather-related sales of raised animals may be deferred into the following year
  • Based upon sales in excess of a normal year
  • Must be cash method farmer
  • Requires Federal disaster declaration
  • Election to defer filed with tax return

Source: Rob Holcomb, University of Minnesota
Depreciation

• Section 179
  • Class life 3-15 qualifies
  • 2022 Max. is $1,080,000
  • Qualifying Purchase limit = $2,700,000
    • Above purchase limit, dollar for dollar reduction of allowable expense.
    • Related party rules (prohibited for lineal descendant).

Source: Rob Holcomb, University of Minnesota
Depreciation

• Bonus Depreciation (Additional first year depreciation)
  • Class life 3 to 20-year property qualifies
    • New or Used (must be Qualifying Acquisition)
  • For 2022, 100% deduction (Last year for 100%)
  • Default is to take bonus. Must elect out by class life.
    • Related party rules allow deduction as long as the asset is new.
      • Lineal Descendant

Source: Rob Holcomb, University of Minnesota
Deferral of Crop Insurance

• Cash basis farmers can defer income, planning is important.
  • Deferral election applies to destruction or damage to crops that results in an insurance or disaster payment.
• Not all crop insurance payments qualify to be deferred.
  • Most revenue-based insurance payments cannot be deferred.

Source: Rob Holcomb, University of Minnesota
Deferral of Crop Insurance

- Report income on cash basis
- Establish that under normal business practice, income from crops would have been reported in the following year.

Source: Rob Holcomb, University of Minnesota
Deferral of Crop Insurance

• Taxpayers must show that more than 50% of income from each damaged crop(s) would be reported in the following year under normal circumstances.

Source: Rob Holcomb, University of Minnesota
Tax Planning

Source: Rob Holcomb, University of Minnesota
## Tax Rates – 2022

<table>
<thead>
<tr>
<th>2022 Threshold for Tax Rates</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%</th>
<th>32%</th>
<th>35%</th>
<th>37%</th>
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<tr>
<td>S</td>
<td>$0</td>
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<td>$41,776</td>
<td>$89,076</td>
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<td>$89,051</td>
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<td>Trusts and Estates</td>
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</table>

Source: Rob Holcomb, University of Minnesota
# Standard Deduction

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFJ/Surviving Spouse (SS)</td>
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<tr>
<td>HH</td>
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<td>Single</td>
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<td>$12,950</td>
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<tr>
<td>MFS</td>
<td>$12,550</td>
<td>$12,950</td>
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<tr>
<td><strong>Additional for age or blindness</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFJ/SS</td>
<td>$1,350</td>
<td>$1,400</td>
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<tr>
<td>Single or HH</td>
<td>$1,700</td>
<td>$1,750</td>
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</tbody>
</table>

Source: Rob Holcomb, University of Minnesota
### Tax Planning Example (Beginning)

<table>
<thead>
<tr>
<th>Description</th>
<th>Wage Income</th>
<th>Schedule F (Farm Income)</th>
<th>Form 4797</th>
<th>Adjusted Gross Income</th>
<th>Standard Deduction</th>
<th>Half SE Tax &amp; QBI</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$ -</td>
<td>$ 196,000</td>
<td>$ -</td>
<td>$ 196,000</td>
<td>$ 25,900</td>
<td>$ 31,672</td>
<td>$ 126,689</td>
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<tr>
<td>Total</td>
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<td>$ 196,000</td>
<td>$ -</td>
<td>$ 196,000</td>
<td>$ 25,900</td>
<td>$ 43,411</td>
<td>$ 126,689</td>
</tr>
</tbody>
</table>

Source: Rob Holcomb, University of Minnesota
Tax Planning Example

- Taxable Income = $126,689
  - Federal Tax = $19,106
  - Self-Employment Tax = $23,477
  - Total Tax = $42,583
- Marginal Tax Rate = 22%
- Effective Tax Rate = 15.1% (Does not include SE tax)

Source: Rob Holcomb, University of Minnesota
Source: Rob Holcomb, University of Minnesota
Tax Planning Example

• Accelerated Depreciation
  • Fast write-off of new equipment
  • $50,000

• Pre-Pay Farm Expense
  • $25,000

Source: Rob Holcomb, University of Minnesota
# Tax Planning Example (Beginning)

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<td>$</td>
<td>$ 196,000</td>
<td>$ 25,900</td>
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<td>$ 31,672</td>
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<tr>
<td>Total</td>
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<td>$ 196,000</td>
<td>$</td>
<td>$ 196,000</td>
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</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
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<td>Write off Mach.</td>
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<td></td>
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<tr>
<td>Pre-Payment</td>
<td>$ (25,000)</td>
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<td></td>
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<tr>
<td><strong>Total</strong></td>
<td>$</td>
<td>$ 121,000</td>
<td>$ -</td>
<td>$ 121,000</td>
<td>$ 25,900</td>
<td>$ 25,859</td>
<td>$ 69,241</td>
</tr>
</tbody>
</table>

Source: Rob Holcomb, University of Minnesota
Tax Planning Example

• Taxable Income = $ 69,241
  • Federal Tax = $7,896
  • Self-Employment Tax = $17,097
  • Total Tax = $24,993
• Marginal Tax Rate = 12%
• Effective Tax Rate = 11.4% (Does not include SE tax)

Source: Rob Holcomb, University of Minnesota
2022 INCOME TAX RATES (MFJ)

Source: Rob Holcomb, University of Minnesota
Tax Planning Analysis

• Spent an additional $75,000 in pre-payment and Accelerated Depreciation.
• Cut tax bill by $17,590
• Saved $.234 of tax for every $ of pre-payment/Accelerated Depr.

Source: Rob Holcomb, University of Minnesota
Thank You!
Contact Information

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