



CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

September 6, 2018

Honorable Ron Kind
U.S. House of Representatives
Washington, DC 20515

*Re: Payment Limitations in H.R. 2, the Agriculture and Nutrition
Act of 2018*

Dear Congressman:

As you requested, the Congressional Budget Office is providing additional information about its cost estimate for H.R. 2, the Agriculture and Nutrition Act of 2018. Specifically, your staff inquired about any direct spending or revenue effects on the budget for the provisions regarding payment limitations in section 1603.

CBO estimates that if the 2014 Farm Bill continued after 2018, federal payments affected by section 1603 would total \$53 billion over the 2019-2028 period and implementing the proposals in that section would increase those payments by \$40 million—an increase of about 0.08 percent—over the same period.

What Are Payment Limitations?

Under current law, agricultural producers may participate in certain income and price support programs operated by the Department of Agriculture (USDA). In general, the benefits due to individual producers under those programs are a function of the number of established base acres, crop yields, and market prices for covered commodities. In addition to those formulas, the law provides for an overall cap (known as a payment limitation) of \$125,000 on the total annual amount a person or legal entity may receive from USDA as a result of participation in those programs.

Exceptions in the law permit payments greater than \$125,000 to certain agricultural operations, depending on the form of ownership and legal organization. For example, sole proprietorships consisting of married couples may qualify for up to \$125,000 each because both spouses in a

single household are considered “actively engaged in farming” even if only one spouse meets the USDA’s criteria for being actively engaged.

Farming operations composed entirely of family members have no limit on the number of members who may qualify for their own individual payment limitation as long as those family members also satisfy USDA’s criteria for being actively engaged in farming. (In late 2015, USDA established a tighter set of criteria for active engagement for entities that include nonfamily members; members of family-only operations can continue to qualify under less-specific criteria.)

Farming operations organized as general partnerships and joint ventures that include nonfamily members may claim as many payment limitations as there are members in those operations if they can comply with USDA’s criteria to be considered actively engaged in farming for nonfamily operations. Spouses of those participating in nonfamily general partnerships or joint ventures also may qualify for separate payment limitations under the spousal exemption described previously.

What Is the Estimated Budgetary Effect of Payment Limitations?

Information from USDA for the 2014, 2015, and 2016 crop years indicates that payment limitations reduced spending for the Agricultural Revenue Coverage (ARC) and Price Loss Coverage (PLC) programs by an average of \$200 million a year, or roughly 3 percent, of the three-year average annual payment made by USDA to farm producers (\$6.7 billion).

For the 2019-2028 period, CBO estimates average ARC and PLC payments will be \$5.3 billion per year. When market conditions dictate that agricultural producers receive lower payments from USDA programs, fewer farm entities are likely to reach payment limitations. Thus, in its most recent baseline CBO estimates that ARC and PLC payments would be, on average, about 2.5 percent (or \$130 million a year) lower because of payment limitations.

USDA data from crop year 2016 also show that 77 percent of ARC and PLC payments went to sole proprietorships, as has been the case historically. That result is not unexpected, considering the large number of base acres a farm would need to have before a sole proprietorship with two spouses reached its maximum payment.

The table below shows the number of payment acres (equal to 85 percent of a farm’s base acres) for major crops that a typical sole proprietorship with two spouses would need to reach \$250,000 in ARC and PLC payments.

	Number of Payment Acres Needed to Reach \$250,000 limit	Ten-Year Average Annual Payment Per Payment Acre in CBO’s Baseline, in Dollars
Corn	8,790	28.44
Soybeans	40,850	6.12
Wheat	15,309	16.33
Seed Cotton	12,768	19.58
Rice	1,709	146.32
Peanuts	1,451	172.27

For example, under CBO’s baseline estimates of future crop prices and yields, a sole proprietorship with its base acres only in corn would need almost 8,800 payment acres (13.7 square miles) to receive a USDA payment of \$250,000. According to the 2012 Census of Agriculture, the average corn farm is 231 acres. Only about 0.1 percent of all corn farms operate on 5,000 acres or more, according to the most recent Census of Agriculture.

Over the decades that USDA program payments have been available, large farms have become complex, multi-million-dollar operations with management capable of reorganizing their businesses to optimize payments. For farming operations that reach the payment limitation, reorganizing to maximize USDA payments is not difficult or costly. Anecdotal information suggests that single entities receiving larger amounts in USDA payments respond to new requirements by splitting into two or more smaller entities to avoid the limitations. Industry experts at USDA and the Government Accountability Office (GAO) generally concur that payment limitations do not significantly limit USDA payments for agricultural price and income support programs to most producers because of the available exceptions and the relative ease of changing the ownership structure of farming operations.

What Changes to Payment Limitations Are Proposed in H.R. 2?

Section 1603 of H.R. 2 would add farm operations that are organized as limited liability companies (LLCs) or S corporations to the types of entities that may claim more than one payment limitation. It also would redefine them as qualified pass through entities, based on their treatment under federal tax law. Under current law, sole proprietorships, general partnerships, joint ventures, LLCs, and S corporations are pass through entities that are not subject to corporate income tax. Instead, income passes through to the individual income tax returns of the owners.

Section 1603 also would add nieces, nephews, and first cousins to the list of family members eligible to receive payments under rules for farming entities composed entirely of family members.

Would the Payment Limitation Provisions of H.R. 2 Increase USDA Payments?

CBO estimates that USDA price and income support payments would average about \$5.3 billion a year over the 2019-2028 period if the provisions of the 2014 Farm Bill continue. CBO estimates that permitting LLCs and S corporations to collect USDA payments of more than \$125,000 would result in an increase of about \$10 million (or about 0.02 percent) in USDA payments over the next decade.

Most farming operations that currently organize as LLCs or S corporations probably do so because they do not regularly expect USDA payments of more than \$125,000. Individual farmers often organize first as corporations and subsequently participate in family farming operations, general partnerships, or joint ventures. In those instances, the existence of a corporation is irrelevant to the payment limitation because it applies to the individual farmer.

USDA began to distinguish between payments to family and to nonfamily farming operations in 2016, when changes to the criteria for being actively engaged in farming for nonfamily operations took effect. A recent analysis from GAO suggests that most operations that received the largest federal payments in 2016 were family farming operations with multiple family members. CBO expects that if such family farming operations organized as LLCs or S corporations after the enactment of H.R. 2, total USDA payments would largely be unaffected.

Similarly, members of currently exempt nonfamily farming operations, such as general partnerships and joint ventures, could reorganize as LLCs or S corporations under the proposed change in H.R. 2 without causing an increase in USDA payments.

CBO estimates that expanding the list of family members to include first cousins, nieces, and nephews would lead to an annual increase in ARC and PLC payments of around \$3 million. That amount is at the midpoint of a range of estimates (from \$1 million to \$5 million) arising from CBO's discussions with USDA and other industry experts. CBO expects that a small number of family farming operations with sufficient payment acres would benefit from the change. However, many larger farming operations that currently include first cousins, nieces, and nephews are probably already organized as joint ventures and general partnerships. Assuming that those extended family members already meet the requirements for active engagement in farming, they qualify for ARC and PLC payments and thus the provision would not significantly expand the number of payees.

Would the Provisions Change Federal Tax Receipts?

CBO estimates that the proposal in H.R. 2 to permit LLCs and S corporations to have the same treatment as joint ventures and general partnerships for purposes of determining the application of USDA payment limitations would not have a significant effect on tax revenues. Joint ventures, general partnerships, LLCs, and S corporations already qualify as pass-through entities. As such, they receive similar treatment under the U.S. tax code and are taxed at the individual income tax level. CBO estimates that any net change in federal tax receipts as a result of the proposed change would be insignificant.

What Factors Contribute to the Uncertainty of this Estimate?

Estimates of the effects of payment limitations on the budget are uncertain. Although many analysts study the effects of payment limitations on farm income, CBO is unaware of any alternative estimates of the cost of the provisions in H.R. 2. The effects of payment limitations depends on many factors, such as the mix of crops on the producer's farm, the payment rate for the eligible crop, and the producer's efforts to reorganize ownership of their operation. As shown in the table above, average payment rates vary considerably by crop. A farm producing both peanuts and soybeans would reach its payment limitation faster with fewer acres than would a farm only

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producing soybeans. Total potential payments for each eligible crop are not static from year to year, but change depending on market prices. Hence, payment limits may only affect some producers intermittently. Producers who consistently face limited payments have an incentive to reorganize their operation to reduce the potential loss of payments.

I hope this information is useful to you. If you need additional information on this topic we will be pleased to provide it. The CBO staff contacts for USDA payment limitations are Jim Langley and Tiffany Arthur.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Hall". The signature is fluid and cursive, with the first name "Keith" being more prominent than the last name "Hall".

Keith Hall
Director

Identical letter sent to the Honorable Earl Blumenauer.