



Inflation Reduction Act: Farm Loan Relief Program Payment

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Rural Tax Education

RuralTax.org



- 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...

Resources



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

- 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



Disclaimer

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A close-up photograph of several stacks of copper coins, likely pennies, arranged in a slightly curved line. The lighting is warm and focused on the coins, creating a sense of depth and texture. The background is a soft, out-of-focus yellowish-gold.

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 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 also paid to cover the next upcoming loan payment.
- Guaranteed Loans through a commercial lender
 - Have also been sent out with in 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 in to 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

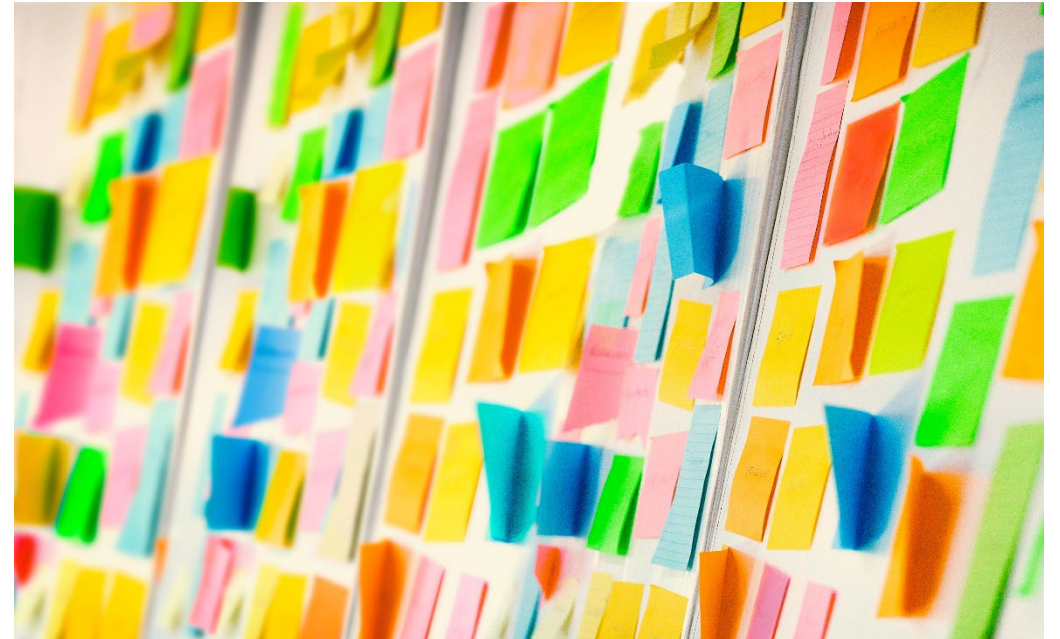
- Given the situation, there may be Net Operating Losses (NOL's). That may be able to be carried forward to offset some of the debt.
- If any capital assets have been purchased utilization of Section 179 or Bonus depreciation. Please be careful as overusing this may create tax issues in the future.
- 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)



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

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

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!



Income Averaging

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



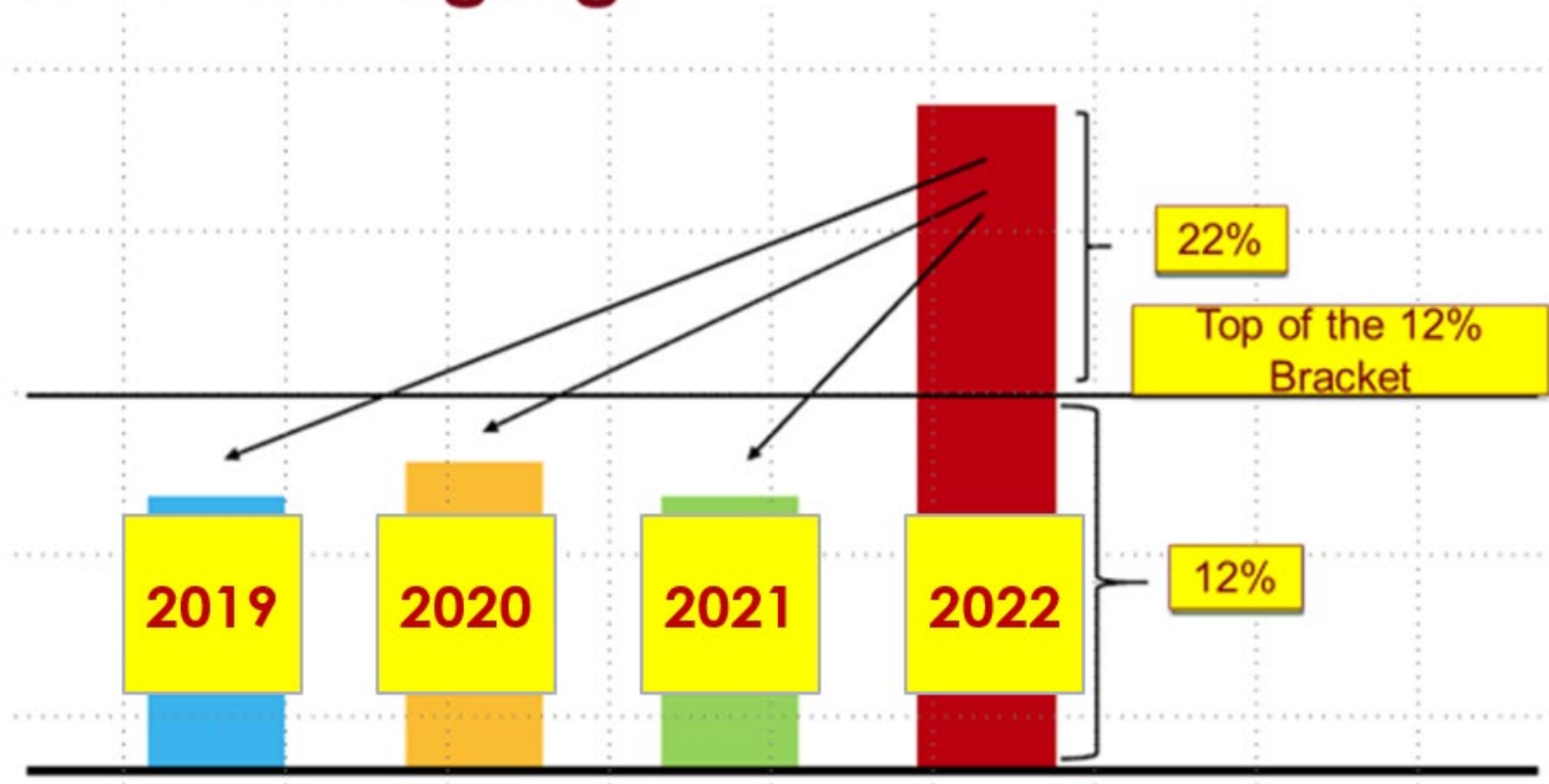
Source: Rob Holcomb, University of Minnesota

Income Averaging

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



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).

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

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

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

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

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).

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

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.



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.



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.



Tax Planning



Source: Rob Holcomb, University of Minnesota

Tax Rates – 2022

2022 Threshold for Tax Rates

	10%	12%	22%	24%	32%	35%	37%
S	\$0	\$10,276	\$41,776	\$89,076	\$170,051	\$215,951	\$539,901
MFJ, QW	\$0	\$20,551	\$83,551	\$178,151	\$340,101	\$431,901	\$647,851
MFS	\$0	\$10,276	\$41,776	\$89,076	\$170,051	\$215,951	\$323,926
HH	\$0	\$14,651	\$55,901	\$89,051	\$170,051	\$215,951	\$539,901
Trusts and Estates	\$0	N/A	N/A	\$2,750	N/A	\$9,850	\$13,450

Source: Rob Holcomb, University of Minnesota

Standard Deduction

Filing Status	2021	2022
MFJ/Surviving Spouse (SS)	\$25,100	\$25,900
HH	\$18,800	\$19,400
Single	\$12,550	\$12,950
MFS	\$12,550	\$12,950
Additional for age or blindness		
MFJ/SS	\$1,350	\$1,400
Single or HH	\$1,700	\$1,750

Source: Rob Holcomb, University of Minnesota

Tax Planning Example (Beginning)

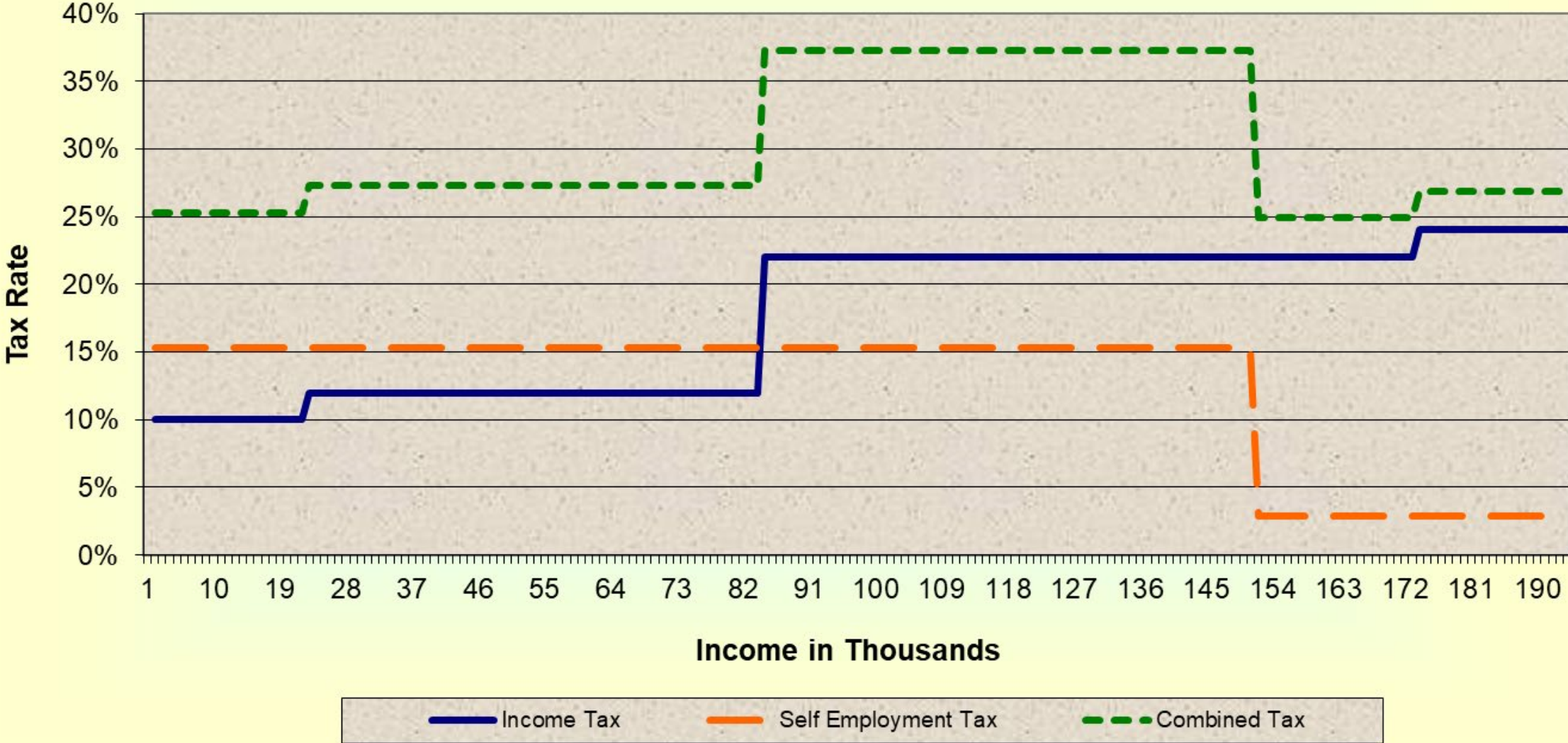
Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 196,000	\$ -		\$ 25,900	\$ 11,739	
QBI						\$ 31,672	
Total	\$ -	\$ 196,000	\$ -	\$ 196,000	\$ 25,900	\$ 43,411	\$ 126,689

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)

2022 INCOME TAX RATES (MFJ)



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



Tax Planning Example (Beginning)

Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 196,000	\$ -		\$ 25,900	\$ 11,739	
QBI						\$ 31,672	
Total	\$ -	\$ 196,000	\$ -	\$ 196,000	\$ 25,900	\$ 43,411	\$ 126,689

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Tax Planning Example

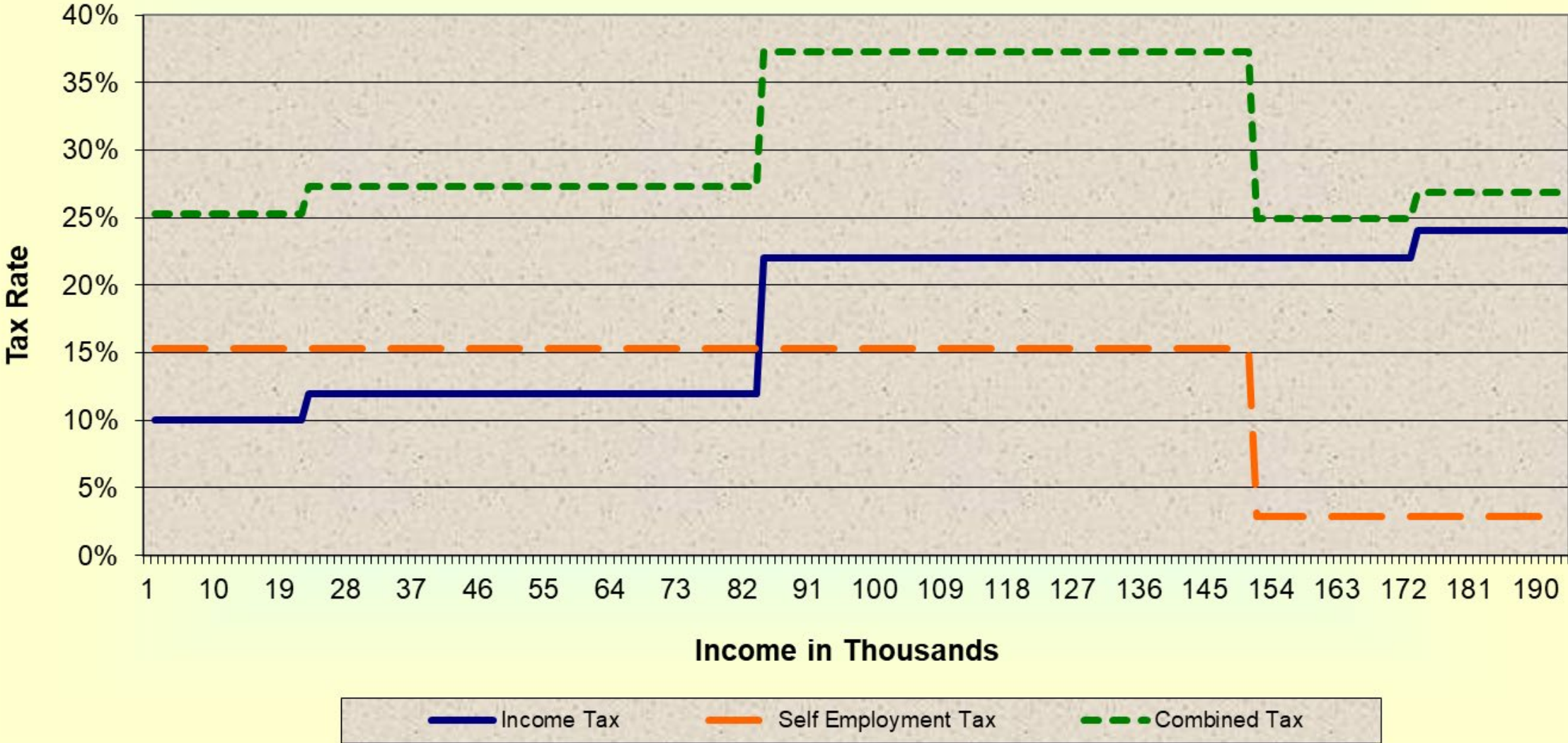
Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 196,000	\$ -		\$ 25,900	\$ 8,549	
QBI						\$ 17,310	
Write off Mach.		\$ (50,000)					
Pre-Payment		\$ (25,000)					
Total	\$ -	\$ 121,000	\$ -	\$ 121,000	\$ 25,900	\$ 25,859	\$ 69,241

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)

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.

Thank You!



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