

TAXATION OF MARKET GAIN AND LDP INCOME, DIRECT AND COUNTER CYCLICAL PAYMENT INCOME

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10/2003

MARKET LOAN REPAYMENT (MLR) AND LOAN DEFICIENCY PAYMENT (LDP) PROGRAM PROVISIONS

1. Market Loan Repayment (MLR) Program:

- The Market Loan Repayment (MLR) program applies **only** to eligible crops that have been placed under CCC non-recourse loan and the CCC loan **has not yet matured**. Crops not under loan are not eligible for the MLR program.
- Eligible crops include any eligible for CCC loan: corn, oilseeds (including soybeans), oats, barley, wheat, and sorghum.
- The MLR program applies when repaying a **current (not yet matured) CCC loan**. Eligibility occurs when the **Posted County Price (PCP)**, on an eligible crop, is **lower than the County Loan Rate plus interest** for that crop. The difference is Market Gain.
- **EXAMPLE**

Assumptions:

- At time of loan:
 - Crop: Corn
 - Amount under loan: 10,000 bushels
 - County Loan Rate: \$1.83 per bushel
 - CCC loan principal:
(10,000 bushels x \$1.83): \$18,300
 - CCC loan interest rate: 5.65%
 - CCC loan interest for 9 mo. loan: \$775
 - Total CCC loan amount 9 month:
(loan principal + interest): \$19,075
 - PCP Total = bushels x PCP
- At time of loan redemption:
 - County Loan Rate: \$1.83 per bushel
 - **Market Gain:**
loan principal – PCP total = positive no.

- **Loan Interest Forgiven** = total loan principal & interest – **the greater of** PCP total or loan principal.
- **Situation 1: PCP higher than loan rate, less than loan principal plus interest (no market gain, interest forgiven)**
 - Crop: Corn
 - Amount under CCC loan: 10,000 bu.
 - County Loan Rate: \$1.83 per bushels
 - PCP: \$1.85 per bushel
 - CCC loan principal:
10,000 bushels x \$1.83 = \$18,300
 - PCP total: 10,000 bushels x \$1.85 = 18,500
 - **Market Gain = \$18,300 - \$18,500 = - \$200 (No Market Gain)**
 - CCC loan principal plus interest: \$19,075
 - **Interest Forgiven:**
\$19,075 - \$18,500 = \$575
 - **Total Advantage: \$575**
- **Situation 2: PCP less than county loan rate (market gain and interest forgiven)**
 - Crop: Corn
 - Amount under CCC loan: 10,000 bushels
 - County Loan Rate: \$1.83 per bushel
 - PCP: \$1.50 per bushel
 - CCC loan principal:
10,000 bushels x \$1.83 = \$18,300
 - PCP total: 10,000 bushels x \$1.50 per bushels = \$15,000
 - **Market Gain: \$18,300 - \$15,000 = \$3300**
 - CCC loan principal plus interest: \$19,075
 - **Interest Forgiven:**
\$19,075 - \$18,300 = \$775
 - **Total advantage: \$3,300 + 775 = \$4,075**
- PCP used in the Market Gain calculation is the PCP on the day the producer selects to initiate the MLR. No future PCP can be used.
- Producer **can not** initiate the MLR program, buy back the bushels, and then elect to take a Loan Deficiency Payment (LDP) on the same bushels.

TAXATION OF MARKET GAIN AND LOAN DEFICIENCY PAYMENTS

2. Loan Deficiency Payment (LDP) Program:

- The Loan Deficiency Payment (LDP) program applies **only** to eligible crops **not yet sold or not yet under CCC loan**.
- Eligible crops include any eligible for CCC loan: corn, oilseeds (including soybeans), oats, barley, wheat, and sorghum.
- The LDP program can be utilized when the eligible crop is still **owned by or under the control of the producer** and the **PCP is less than the County Loan Rate** for that specific crop.
- **EXAMPLE:**
 - Crop: corn
 - County Loan Rate: \$1.83 per bushel
 - PCP: \$1.50 (changes daily)
 - **LDP rate:**
\$1.83 (County Loan Rate) - \$1.50 (PCP)
= \$.33 per bushel LDP rate
 - **Total LDP payment = LDP rate per bushel**
x total bushels
- Producer can not receive LDP on crop not yet harvested. Crop must be eligible for CCC loan.
- Producer can not receive LDP on crop bushels that have been placed under CCC loan.
- Producer can not receive LDP on crop bushels he/she have already sold, delivered on contract, or fed.
- Producer can not put the same bushels under CCC loan for which a LDP has been received.
- Producer can choose the day to initiate the LDP and designate the bushel quantity. He/she **can not** “lock in” the PCP and LDP rate. The PCP, and therefore the LDP rate, on the day the producer completes the paperwork is the PCP and LDP used in his/her transaction calculation.
- Producer can elect to take an LDP on any eligible crop up through the deadline for placing that crop under CCC loan (May 31 of the year following production).
- Producer can claim LDP on corn silage (contact your local FSA office staff for reporting details).

1. Market Gain from Market Loan Repayment (MLR) Program:

- Producers, when placing crops under CCC loan, can elect to record the transaction as a loan or as income for tax purposes. Reporting gain is calculated slightly different for each.
- Beginning in 2001, farmers are allowed to change from the income method of reporting CCC loans to the loan method with automatic consent of the IRS. All loans reported in a calendar year must receive the same tax treatment. IRS Form 3115 must be filed with the tax return. Farmers can return to the income method in any subsequent year by election. Check with your tax preparer.
- The Farm Service Agency (FSA) will issue a Form 1099 for the difference between the County Loan Rate and the PCP. As described earlier, this amount is the amount of Market Gain from the buy back of the CCC crop loan, if the PCP is less than the County Loan Rate.
- **EXAMPLE # 1: Grain Sold for More than PCP:**
 - Assume a corn CCC loan with a County Loan Rate of \$1.83 per bushel. The CCC loan is repaid at a PCP of \$1.50 per bushel and is later sold for \$2.05 per bushel. **FSA will issue a Form 1099 for \$.33 per bushel.**
 - **Loan Method Tax Reporting:**
 - No income reported when securing the CCC loan.
 - Report the \$.33 per bushel Market Gain from Form 1099 as a government payment.
 - Report the \$2.05 per bu. as sale of grain.
 - Total reported gain for tax purposes:
\$.33 + \$2.05 = \$2.38 per bushel.
 - **Income Method Tax Reporting:**
 - Report as income the \$1.83 per bushel when securing the CCC loan.
 - Report \$.55 per bushel gain from the grain sale (\$2.05 - \$1.50 basis).
 - Total reported gain for tax purposes:
\$1.83 + \$.55 = \$2.38 per bushel

• **EXAMPLE # 2: Grain Sold for Less than PCP**

– Assume a corn CCC loan with a County Loan Rate of \$1.83 per bushel. The CCC loan is repaid at a PCP of \$1.50 per bushel and later sold for \$1.40 per bushel. **FSA will issue a Form 1099 for \$.33 per bushel.**

– **Loan Method Tax Reporting**

- No income when securing the CCC loan.
- Report the \$.33 per bushel Market Gain from Form 1099 as gain.
- Report the \$1.40 per bushel sale as gain.
- Total reported gain for tax purposes:
 $$.33 + \$1.40 = \$1.73$ per bushel

– **Income Method Tax Reporting;**

- Report as income the \$1.83 per bushel when securing the CCC loan.
- Report \$.10 per bushel loss on Schedule F (\$1.40 - \$1.50 basis).
- Total reported gain for tax purposes:
 $\$1.83 - \$.10 = \$1.73$ per bushel

– **Caution:**

- When buying back grain under CCC loan using the **income method**, it becomes an “item held for resale” and the expense of the buy back can not be deducted on the Schedule F until the grain is actually sold or used as livestock feed.

• **EXAMPLE # 3: Grain Bought Back**

– As a taxpayer who reports CCC loans as income, you receive a CCC loan for \$10,000 in November after harvest and repay it a month later in December of the same year. The PCP is less than the loan rate so you buy back the loan for \$8,500. You sell the grain in January of the next year for a total of \$9,500. The \$10,000 loan proceeds are income for the year received. The \$8,500 **is not** an expense for the year you repaid the loan but is a deduction against the sale of the grain the following year. You report a net sale of \$1,000 ($\$9,500 - \$8,500$) in the year the grain is sold.

2. Loan Deficiency Payments (LDP):

- A LDP payment is considered a direct cash payment. It is therefore fully taxable in the year received.

• **Example # 1:**

– John has 10,000 bushels of corn. His County Loan Rate is \$1.83 per bushel. On October 12th, during harvest, the PCP is \$1.54 per bushel. This equals a \$.29 per bushel LDP. John contacts his county FSA office and utilizes the LDP program and receives a total LDP payment of \$2,900 ($\$10,000$ bushels x \$.29 per bushel LDP rate). He then has a \$2,900 LDP taxable income that year as a result of the transaction.

TAXATION OF 2002 FARM BILL DIRECT PAYMENTS (DP) AND COUNTER CYCLICAL PAYMENTS (CCP)

1. Direct Payments (DP):

- Direct Payments (DP) are guaranteed under the 2002 Farm Bill. The DP replaces the former AMTA payments under the 1995 farm program. An Advanced Payment of up to 50% of the total payment can be made beginning Dec. 1 of the calendar year before the covered commodity crop is harvested. The producer has the option of delaying the Advanced Payment until the next year. The second 50% portion of the payment is received in fall of the year the crop is produced.

DP rates for covered commodity crops for 2002-2007 are as follows:

- Corn - \$.28 per bushel
- Soybeans - \$.44 per bushel
- Wheat - \$.52 per bushel
- Oats - \$.024 per bushel
- Barley - \$.24 per bushel
- Sorghum - \$.35 per cwt./bushel
- Minor Oilseeds - \$.008 per pound

DP are calculated as follows: $\text{PFC Base Acres} \times .85 \times \text{PFC Payment Yield} \times \text{Payment Rate}$

- Direct Payments are considered a direct cash payment and are taxable in the year received.

Example 1: If a producer signs up in the fall for the next year’s program and elects to take the 50% Advanced DP Payment, the producer would receive that payment beginning Dec. 1 of the year

of sign-up. The second portion of the DP would be made in the fall of the year the crop is produced and harvested. In this case, the producer would receive DP income on this one crop in two different years. The producer would have taxable income spread over two years.

Example 2: If the producer decided not to take the income in the current year, they would wait and sign-up after January 1 of the year the crop would be produced and harvested. The 50% advance payment would be made followed by the second 50% payment in the fall of the year the crop was produced and harvested. This producer would receive the crop DP all in the same year and the income would then be taxable income all in one year.

2. Counter Cyclical Payments (CCP):

- Counter Cyclical Payments (CCP) are a part of the 2002 Farm Bill and are meant to replace previously made Market Loss Assistance and Oilseed Payments.
- CCP are not guaranteed and must be earned before a payment is made. CCP are based upon a 12-month marketing year and are a weighted average of national price and bushels sold.
- Maximum CCP rates are as follows:
 - Corn - \$.34 per bushel
 - Soybeans - \$.36 per bushel
 - Wheat - \$.52 per bushel
 - Oats - \$.026 per bushel
 - Barley - \$.09 per bushel
 - Sorghum - \$.21 per cwt./bushel
 - Minor Oilseeds - None

CCP can range from zero to these maximum rates.

CCP, if earned, are calculated as follows:

Base Ac. x .85 x Payment Yield x Payment Rate

- Counter Cyclical Payments are considered cash payments and are taxable in the year received. CCP can occur over a 12-month period beginning in the fall of the year the eligible crop was produced.

That means, if the CCP are earned, payments on a given crop could contribute to taxable income in two different years.

BOTTOM LINE

- Understand the difference between the MLR and LDP programs. This is crucial to understanding how the gain from each is calculated as well as the related tax implications.
- Keep good records especially when using the “CCC loan as income method” for tax reporting. When using this method of reporting, there is a higher probability of over reporting gain.
- Work closely with your accountant and/or tax preparer when dealing with MLR and LDP gain. This will help minimize your tax liability.
- Check with your tax accountant if you plan to switch from one method of accounting for CCC loans to another. The tax laws have changed.
- The 2002 Farm Bill includes what is termed Direct Payments (DP). At sign-up, a producer can receive 50% of the DP. The second 50% of the DP is received in the fall the crop is produced. If the producer signs up in the fall for the following year’s program, the DP will be received in two different years. This will require good records for tax and cash flow purposes.
- The 2002 Farm Bill also includes what are referred to Counter Cyclical Payments (CCP). If prices are low, the CCP is earned and will be paid to producers. If earned, the payments will be made 35% in the year the crop was produced and 65% in the following year. That means producers must keep very good records in order to complete tax reports and cash flow planning.

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