Office of Chief Counsel
Internal Revenue Service
memorandum

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subject: Non-Taxpayer Specific Advice – Taxability of Market Facilitation Program Payments; 2018 Instructions for Schedule F, Profit or Loss From Farming

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether Market Facilitation Program (MFP) payments authorized by the United States Department of Agriculture (USDA) Trade Aid package are includible in gross income under Internal Revenue Code section 61 and generally includible in net earnings from self-employment under section 1402.

CONCLUSION

Absent legislation providing specific income exclusion for these MFP payments, the amounts received by farmers as MFP payments must be included in gross income under section 61 and are generally included in net earnings from self-employment income under section 1402.

FACTS

The USDA Trade Aid Package is a temporary assistance program designed to assist farmers who experience a financial loss as a result of recent regulatory tariffs imposed by foreign trading partners that target U.S. agricultural products. This is not part of a bill, but instead the USDA is acting under its authority under Section 5 of the Commodity Credit Corporation (CCC) Charter Act.[1] The USDA has authorized the Trade Aid

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[1] 15 U.S.C. § 714c (a) authorizes the CCC to use its "general powers" to "[s]upport the prices of

Package to provide up to $12 billion in financial assistance for the following three programs: (1) the MFP, which gives direct payments to producers of specified crops adversely affected by the tariffs; (2) the Food Purchase and Distribution Program ($1.4 billion), under which the USDA will purchase excess food supplies from farmers and distribute to food banks and other nutrition programs; and (3) the Agricultural Trade Promotion Program ($200 million), which provides funds to eligible U.S. agricultural organizations to promote U.S. food and agricultural goods overseas. Market Facilitation Program, 7 C.F.R. pt. 1409 (Aug. 30, 2018); Randy Schnepf, Megan Stubbs, Jim Monke, and Jenny Hopkinson, Cong. Research Serv., R45310, Farm Policy: USDA's Trade Aid Package (Sept. 26, 2018).

Our main concern is taxation of the MFP payments; this program will receive the bulk of the funding ($4.7 billion for the first round of payments, and can receive approximately $10 billion of the total $12 billion allotted for the package), the greatest share of which is expected to be paid to soybean farmers, who have been most affected by the tariffs. The purpose of the MFP payments is to make up for the depressed prices of certain commodities caused by the tariffs, and payments are tied to actual 2018 production (i.e. the amounts actually produced in 2018), so producers experiencing drought or other natural disasters will actually receive less than those who are not experiencing these problems and have a normal production level for 2018. Schnepf et al. at 4-5.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code and section 1.61-1 of the Income Tax Regulations generally provide that, except as otherwise excluded by law, gross income means all income from whatever source derived. The term "income" is broadly defined as "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). Section 1.61-4(a)(4) and (b)(4) of the Income Tax Regulations states that farmers must include in gross income "[a]ny subsidy or conservation payments which must be considered as income".[2] The scope of section 61(a) is broad, and exclusions from income are narrowly construed. See Commissioner v. Schleier, 515 U.S. 323, 328 (1995); United States v. Burke, 504 U.S. 229, 248 (1992); Commissioner v. Glenshaw Glass Co., 348 U.S. at 429-430.

The courts have consistently held that payments intended to compensate a taxpayer for lost profits must be included in gross income. See Longino v. Commissioner, 32 T.C. 904 (1959) (settlement payments to farmer to compensate for loss profits due to crop damage caused by use of insecticide properly taxed as ordinary income). The courts

agricultural commodities (other than tobacco) through loans, purchases, payments, and other operations."

[2] Treas. Reg. § 1.61-4(a)(4) states that a "farmer using the cash receipts and disbursements method of accounting shall include in his gross income for the taxable year... [a]ll subsidy and conservation payments received which must be considered as income". Treas. Reg. § 1.61-4(b) states that a "farmer using an accrual method of accounting must use inventories to determine his gross income...by adding the total of the items described in subparagraphs (1) through (5) and subtracting therefrom the total of the items described in subparagraphs (6) and (7)" and subparagraph (4) lists "[a]ny subsidy or conservation payments which must be considered as income".

have also held that government subsidy and conservation payments are properly includible in gross income. See Baboquivari Cattle Co. v. Commissioner, 135 F.2d 114 (9th Cir. 1943) (conservation payments to farmer in exchange for compliance with prescribed governmental standards were includible in gross income); G.A. Stafford & Co. v. Pedrick, 171 F.2d 42, 43 (2d Cir. 1948) (government cotton export "subsidy payments are plainly within the definition of 'gross income'"); Driscoll v. Commissioner, T.C.M. (P-H) P 44, 021 (1944), aff'd in part and rev'd in part, 147 F.2d 493 (5th Cir. 1945) (government payments for the cost of constructing water tanks on taxpayer's ranch pursuant to a range conservation program were includible in gross income); Dubay v. Commissioner, T.C. Memo. 1979-418 ("Federal subsidy payments made on behalf of a taxpayer have long been treated as gross income"); Harding v. Commissioner, T.C. Memo. 1970-179 (government payments to farmer intended to subsidize cost of capital improvement were includible in gross income).

The Service has also adhered to this principle, issuing a number of revenue rulings requiring the inclusion in gross income of subsidy or conservation payments received by farmers, including those payments intended to compensate for lost profits. See Rev. Rul. 73-408, 1973-2 C.B. 15 (cancellation of an assistance loan to farmer who suffered uninsured crop damage is includible in gross income as a substitute for lost income); Rev. Rul. 68-44, 1968-1 C.B. 191 (payments to farmers to encourage them to divert land to nonagricultural uses is substitute for farm income and includible in gross income).

Self-Employment Contributions Act (SECA) tax is imposed on the self-employment income of every individual. I.R.C. § 1401. "Self-employment income" is defined as the "net earnings from self-employment" derived by an individual with certain limitations. I.R.C. § 1402(b). "Net earnings from self-employment" generally means the gross income derived by an individual from any trade or business, carried on by such individual, less the deductions allowed which are attributable to such trade or business, plus the individual's distributive share of income or loss from any trade or business carried on by a partnership of which he is a member with certain enumerated exclusions. I.R.C. § 1402(a). The term "trade or business" when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses), with certain listed exceptions. I.R.C. § 1402(c). Earnings derived from an individual taxpayer's trade or business, including agricultural program payments, are generally includible in self-employment income and subject to SECA tax. Ray v. Commissioner, T.C. Memo. 1996-436, 1996 WL 540112 at *2.

The MFP payments have some similarities with prior agricultural program payments intended to compensate farmers for lost income when market prices were low, known as counter-cyclical payments and price loss coverage payments. Counter-cyclical payments (formerly called deficiency payments) were payments that producers of specified crops received when market prices were low; they were calculated as the difference between a crop's target price and a lower season-average market price. These types of payments were first implemented in 1973, but were discontinued in the 1996 farm bill, and then reinstated in the 2002 and 2008 farm bills (payments were extended through 2012). Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, § 1101-1108; Food, Conservation, and Energy Act of 2008, Pub. L. No., 110-246, § 1101-1109; Jim Monke, Cong. Research Serv., RS21779, Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans 3 (Dec. 13, 2004). The 2014 farm bill also enacted similar payments called price loss coverage payments. Agricultural Act of 2014, Pub. L. No. 113-79, § 1116; Randy Schnepf, Cong. Research Serv., R43817, 2014 Farm Bill Provisions and WTO Compliance 7, 16 (Apr. 22, 2015).

Counter-cyclical and price loss payments also have eligibility requirements and overall payment cap similar to MFP payments; unlike the MFP payments they did not depend on current production, but instead were triggered when market prices were below a set amount. Farm Security and Rural Investment Act of 2002 § 1104; Food, Conservation, and Energy Act of 2008 § 1104; Agricultural Act of 2014 § 1116.

The Service has previously provided guidance about the taxability of counter-cyclical and price loss payments on the Schedule F, Profit or Loss From Farming, and in Publication 225, Farmer's Tax Guide. The Service previously stated in the Instructions for Schedule F and Publication 225 that counter-cyclical payments and price loss payments are includible in gross income, similar to other agricultural program payments.[3] For example, the 2003 Publication 225 states in the section "Agricultural Program Payments" that taxpayers "must include in income most government payments, such as those for approved conservation practices, direct payments, and counter-cyclical payments, whether you receive them in cash, materials, services, or commodity certificates...The Farm Security and Rural Investment Act of 2002 created two new types of payments – direct and counter-cyclical payments. You must include these payments on Schedule F, lines 6a and 6b."

Here, the MFP payments are government subsidies paid for the purpose of compensating farmers of specified crops for lost profits. There is currently no legislation excluding these payments from gross income. Thus, under the caselaw and guidance discussed above, the MFP payments are includible in gross income under section 61(a). These payments are also generally includible in net earnings from self-employment and subject to SECA tax.

[3]See (1) Instructions for Schedule F for 2004 through 2017 and (2) Publication 225 for 2003 through 2017. For cash method taxpayers, agricultural program payments are reported on Schedule F, Lines 6a & 6b for 2002 through 2010, and on Schedule F, Lines 4a & 4b for 2011 through 2017. For accrual method taxpayers, agricultural program payments are reported on Schedule F, Lines 40a & 40b for 2002 through 2010, and on Schedule F, Lines 39a & 39b for 2011 through 2017. For all of these lines, Line a is for the total amount of payments received and Line b is the taxable amount.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call (202) 317-4718 if you have any further questions.