



Farm Tax Network™

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PLC/ARC and the Farm Loss Limitation Rule

Since 2010, the tax law has limited farm losses to \$300,000 (or the last 5 years of farm net income, if greater), but only if the taxpayer participates in USDA subsidy programs. Direct payments are gone. With the new PLC or ARC payments to farm producers, we point out that most may now escape the reach of this loss limit.



Background: The “Excess Farm Loss” Rule

Low crop prices in recent months have increased the possibility that farming operations will sustain losses. Beginning with the 2010 tax year, the excess farm loss rule limits deductible farming losses to farming operations that are not C corporations and that receive an “applicable subsidy” as that term is defined by Sec. 461(j). The limitation on farming losses is the greater of \$300,000 (\$150,000 in the case of a farmer filing as married filing separately) or aggregate net farm income over the previous five-year period. Excess farm losses that are disallowed can be carried forward to the next tax year and treated as a deduction from that year.

The “Applicable Subsidy” Definition

The definition of “applicable subsidy” is contained in Section 15351 of Public Law 110-234 (the 2008 Farm Bill). That provision amends Sec. 461 by adding subsection (j), with the definition of the term contained in subsection (j)(3). That subsection reads as follows:

For purposes of this subsection, the term “applicable subsidy” means—

(A) any direct or counter-cyclical payment under title I of the Food, Conservation, and Energy Act of 2008, or any payment elected to be received in lieu of any such payment, or

(B) any Commodity Credit Corporation loan.

The 2014 Farm Bill created price loss coverage (PLC) and agricultural risk coverage (ARC), repealed direct payments and counter-cyclical payments, and continued loan deficiency payments (LDPs) through 2018. However, the 2014 Farm Bill did not modify Sec. 461, even though the subsidies referred to in Sec. 461(j)(3)(A) were repealed. That leaves only CCC loans (and LDPs in lieu of CCC loans) as currently within the definition of “applicable subsidy” for purposes of the excess farm loss rule. The instructions to Schedule F, Form 1040, are consistent with this observation.

Note: Producers who have not “sealed” their grain can elect to receive an LDP, but if the producers seal their grain, the CCC loan can be paid off at the lesser of the posted county price or loan rate (known as “market gain”). Thus, an LDP is a direct payment made to a producer with respect to a commodity where the producer has a beneficial interest in a commodity. The payment is in lieu of a marketing assistance loan. LDPs occur when the CCC-determined value, which is based on the current local price in a county, is below the applicable county loan rate. The payment is the difference between the two rates multiplied by the eligible quantity.

The updated instructions for line 35 of Schedule F state that the taxpayer’s farm loss is only limited if the taxpayer or the taxpayer’s partnership or S corporation received a CCC loan.

In addition to the “excess farm loss” rule, we remind that there are other barriers to the current deductibility of farm losses:

- **The “At-Risk” Rule:** For farming operations that are organized as S corporations or are unincorporated, the deductible loss for the year is limited to the amount that the farmer has at risk in the farming business. Under Sec. 465, a farmer is generally considered to be at risk for the amount of money and basis in property that the farmer contributes to the farming operation and the amount of farm debt for which the farmer is personally liable.
- **S Corporation Stock or Loan Basis:** For farming operations organized as S corporations, the shareholder must also have basis either in S corporation stock or in direct loans to the S corporation. As with the at-risk rules of Sec. 465, if current losses are limited, they carry forward until the taxpayer has basis.
- **Passive Loss Rule:** Farm income will either be classified as “active” or “passive.” The line between the two hinges on the farmer’s level of participation in the farming activity. If the farmer’s participation satisfies one of several material participation tests under Sec. 469, then the income from the farming activity will not be passive, and resulting losses from the activity will be fully deductible. Otherwise, the loss will be limited for tax purposes to the extent of the farmer’s passive income from other sources, with the excess becoming a passive loss carryover.

Handling Farm Losses on the Return

Deductible farming losses (i.e., those not limited by the “at-risk” rule, S corporation basis, the passive loss rule or the “excess farm loss” rule) can be used to reduce taxable income for prior or future tax years. Generally, a farming net operating loss can be carried back five years or carried forward 20 years. However, a farm taxpayer can irrevocably elect to decline the special five year farm loss carry back rule, and default to the general loss carry back rule of two years. Or a farm taxpayer may irrevocably elect to waive the entire carryback period, resulting in carrying the loss forward for up to 20 years. The choice of carrying back the loss first to the fifth preceding year or the second preceding year, or forgoing the entire carryback period depends upon the relative tax brackets of the earlier years versus the expected tax brackets of the future years.

Conclusion

Farm losses can be subject to several loss limitations. However, because of the 2014 Farm Bill, there is a diminished chance that the excess farm loss limitation rule applies to farming operations that are not C corporations. In those cases where taxpayers used a cash method farming activity to shelter other non-farming income and had been advised to avoid USDA participation, that advice now can be altered. Those taxpayers only need to avoid USDA participation in CCC loans and LDP subsidies.

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