AGI Issues with SDRP

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Overview

The USDA's Supplemental Disaster Relief Program (SDRP) aims to provide a vital safety net for agricultural producers affected by natural disasters. However, its reliance on IRS AGI has created significant inequities and undermines the program's purpose in many instances. AGI, a general measure of a taxpayer's income, fails to accurately represent the complex financial realities of modern farming operations, particularly those with sophisticated business structures.

History of the Issue

The Emergency Commodity Assistance Program (ECAP) allowed producers to receive an extra payment limit if more than 75% of their "gross income" was from farming. But this computation was only for ECAP where "AGI" meant "average gross income." However, for the SDRP "AGI" means "adjusted gross income." Thus, under the SDRP, a producer needs net income from farming to qualify for an extra payment. This remains an issue because currently equipment gains and income from custom farming is not be considered as farm income unless a producer's "normal" farm AGI is at least two-thirds of total AGI. Under the OBBBA, starting with the 2025 crop year, the definition of farm income will automatically include equipment gains (along with income from agri-tourism activities and income from the direct marketing of farm commodities to consumers).

However, general partnerships and joint ventures are now considered to be a qualified pass-through entity, and these entities will now be subject to AGI limitations also (at least this is our current understanding). This may mean that some farm general partnerships may not meet the AGI tests that were not applicable in the past. We are in the process of determining whether that is correct or not and will keep you posted on it.

Illustration:

The difference between the two AGI calculations is a classic example of how two programs using the same acronym can have vastly different outcomes for farmers.

As noted, for ECAP, "AGI" refers to Average Gross Income. This calculation is specific to ECAP and is used to determine if more than 75 percent of a farmer's income is from farming, which qualifies them for a higher payment limit.

- **What it includes:** The ECAP AGI calculation starts with a producer's total income before most adjustments and deductions. It includes income from all sources - farming, off-farm jobs, investments, and any other revenue.
- **The calculation:** To determine the percentage of farm-based income, the program looks at a three-year average.
    - **Step 1:** Calculate the total gross income from all sources (farm and non-farm) for the three relevant tax years.
    - **Step 2:** Calculate the total income derived *specifically from farming* for the same three years.
    - **Step 3:** Divide the total farm income by the total gross income.

Example for ECAP: Farmer A is a corn and soybean producer who also sells insurance on the side to supplement his farm income.

- **Year 1:** $100,000 in gross farm income + $50,000 in gross non-farm income = $150,000 total gross income.
- **Year 2:** $120,000 in gross farm income + $60,000 in gross non-farm income = $180,000 total gross income.
- **Year 3:** $110,000 in gross farm income + $40,000 in gross non-farm income = $150,000 total gross income.

ECAP AGI Calculation:

- **Total gross farm income (3 years):** $100,000 + $120,000 + $110,000 = $330,000
- **Total gross income (3 years):** $150,000 + $180,000 + $150,000 = $480,000
- **Percentage from farming:** $330,000 / $480,000 = 68.75%

In this scenario, Farmer A does not meet the 75% threshold and would therefore be limited to the lower payment limit under ECAP.

AGI for SDRP

As noted, "AGI" refers to "Adjusted Gross Income," which is the figure from Line 11 on Form 1040. This is a very different calculation.

- **What it includes:** This is your total income from all sources, *minus* certain "above the line" deductions and adjustments. These can include deductions for things like IRA contributions, student loan interest, or a portion of self-employment tax.
- **The Problem for Farmers:** The biggest issue for complex farm businesses is that this AGI figure can be significantly reduced by non-cash expenses like depreciation, as well as pass-through losses from other business entities.

Example for SDRP: Farmer B is a cattle rancher who has a feedlot business structured as an S-corporation and a separate grain operation as a partnership. Both entities pass losses and expenses to him as an individual.

- **IRS Tax Return (Form 1040, Line 11):**
  - Gross Farm Income from all sources: $1,500,000
  - **Less:** Substantial depreciation on new equipment: -$500,000
  - **Less:** Pass-through losses from feedlot S-Corp: -$300,000
  - **Less:** Pass-through losses from grain partnership: -$100,000
  - **Less:** Other "above the line" deductions: -$50,000
  - **Final AGI:** $1,500,000 - $500,000 - $300,000 - $100,000 - $50,000 = $550,000

In this example, Farmer B's AGI is a much smaller number due to accounting rules, even though his operation had a high gross income. If the SDRP has a payment limit based on a much lower AGI threshold (e.g., $250,000 or $900,000 depending on the program), this farmer's substantial losses might not be fully reflected because his AGI is still too high to qualify for the full benefits he would otherwise be entitled to. The AGI figure on his tax return doesn't tell the whole story of his financial losses.

Observation: The problem is that the SDRP AGI calculation doesn't accurately reflect a farmer's actual financial loss. While it seems like a lower AGI would be a good thing, it's a huge problem when you're trying to prove a substantial financial hit from a disaster. Based on the example, this is a problem for the following reasons:

- **Gross Income is the Real Measure of Business Size:** In the example, Farmer B has a gross farm income of $1.5 million. This figure represents the total revenue from his operations before expenses. It's the most straightforward measure of the scale and financial activity of his business. A $1.5 million operation is a large-scale enterprise with significant assets and expenses.
- **AGI is a Tax-Calculation Figure:** AGI is a highly manipulated number designed to reduce the tax bill. In the example, a total of $950,000 in legitimate deductions (depreciation, pass-through losses) were subtracted from the gross income. This is a common and legal tax strategy for complex businesses.
- **The Inequity:** The problem arises when the USDA uses the lower AGI figure to determine a payment limit for disaster relief. The farmer, who has a $1.5 million operation and may have suffered hundreds of thousands of dollars in crop or livestock losses, is judged by a final AGI of only $550,000. If the SDRP has a payment cap of, say, $900,000, this farmer's $1.5 million business is automatically penalized, as their AGI is too high to get the full benefits they might be entitled to, even though their financial position has been severely compromised by a disaster.

The specific deductions in the example highlight the core of the issue:

- **Depreciation:** This isn't a cash expense, but it's a crucial accounting tool. A farmer might buy a new $500,000 tractor and depreciation allows them to spread that cost out over many years for tax purposes. By including it in the AGI calculation, the SDRP effectively says, "You made an investment, so you're not as financially distressed."
- **Pass-Through Losses:** This is a key feature of partnerships and S-corporations. The losses from one part of a diversified business (like the feedlot) are passed on to the owner's personal tax return. This is intended to help the owner offset income, but under the SDRP rules, it can make their overall AGI look much higher than it really is. This is especially problematic in a disaster scenario, where a farm may have suffered substantial physical losses but still have a high AGI because of unrelated income.

In short, the AGI on a tax return does not represent a farmer's actual economic situation after a disaster. It is an artificial number created by tax law. By using this figure, the SDRP unfairly disqualifies or limits the benefits for the very producers who often have the most to lose and the most complex operations to protect. For many producers, particularly those operating as partnerships, S-corporations, or multi-entity businesses, AGI (as computed for SDRP purposes) can be a misleading indicator of financial health. This is because a producer's AGI may include income from multiple sources or business entities, leading to an inflated figure that does not reflect the true financial impact of a disaster on their farming operation. The result is a system where producers who have suffered substantial, documented losses - as verified by data from the Farm Service Agency (FSA) - are either disqualified from receiving aid entirely or receive reduced benefits, simply because the AGI definition for SDRP purposes is an inaccurate reflection of the farm's performance.

Lack of Transparency

A further complication is the lack of transparency in how the USDA interprets and applies AGI data to determine eligibility and payment amounts. This leaves producers in the dark, unable to understand why their claims may have been denied or their benefits reduced. The absence of clear public guidance on how complex business structures are evaluated adds to the frustration and inequity.

To fix these systemic issues, the SDRP's AGI computation method should undergo reform. Possible solutions include:

- **Updated AGI Evaluation Procedures:** The USDA should develop new procedures that more accurately account for the unique financial characteristics of farming operations. This could involve using a more tailored metric than the standard AGI, perhaps one that isolates farm-specific income and expenses.
- **Inclusion of Farm-Specific Accounting Factors:** The program's criteria should be updated to consider critical factors like depreciation schedules, pass-through losses, and other farm-specific

accounting variables that are essential for a realistic assessment of a producer's financial health following a disaster.

- **Clearer Guidance and Appeals Process:** The USDA must provide clearer, more accessible guidance on how eligibility is determined. This would allow producers and their financial advisors to better understand the program's requirements and navigate the application process. A more transparent and robust appeals process would also ensure that producers who are unfairly denied benefits have a clear path to recourse.

Yet Another Issue – Joint Returns

For purposes of the SDRP, the AGI is based on the figure from a the producer's tax return. When a farmer files a joint return with their spouse, if the spouse has income from an off-farm job, that income is included in the AGI calculation - the IRS combines all income and deductions for both individuals into a single, unified return. The AGI figure on that return (Line 11) is the combined AGI for both spouses.

Example:

- **Farmer C:** Has a farm business with farm-related AGI (after deductions for depreciation, etc.) of $150,000.
- **Spouse D:** Works as a nurse with AGI from her job of $80,000.

If they file a joint tax return, their combined AGI that is reported to the USDA for SDRP purposes would be $230,000.

The issue is that the spouse's off-farm income inflates the AGI, making it harder for the family to meet the program's eligibility requirements or receive the full amount of disaster relief they would otherwise be entitled to.

In the example, if the farmer had filed separately and their farm income AGI was below a certain threshold, they might qualify for a higher payment. But because the spouse's income pushes their combined AGI higher, they may be subject to a lower payment cap. Also, in some cases, a high combined AGI could disqualify a farmer from receiving any benefits at all, even if the farm operation suffered a catastrophic loss. The off-farm income of a spouse, while a legitimate part of the household's finances, is completely unrelated to the agricultural disaster, yet it can be the sole reason a family is denied assistance.

Observation: The SDRP rules, because they rely on the final AGI on the tax return, do not differentiate between farm income and non-farm income for this specific purpose. The program sees a single AGI figure and uses it as the basis for eligibility, regardless of the source of income. This is in direct contrast to programs like the ECAP, which created a specific calculation for "average gross farm income."

In short, a farmer's spouse with an off-farm job can be a financial lifesaver for the family, but under the SDRP's current rules, that income can also act as a penalty, potentially preventing the family from receiving needed disaster relief.

Conclusion. Without these crucial reforms, the SDRP will continue to fail many of the producers it was designed to help. The current system penalizes sophisticated and successful farming operations, leaving them vulnerable during a disaster and undermining the long-term stability of the U.S. agricultural sector. Perhaps some changes will be made along these lines for Stage 2 of the program when the rules are announced in mid-September.