Farmers' Guide to Changes in Taxation of Inflation Reduction Act (IRA) Loan Payments

April 19, 2023

Farmers' Legal Action Group
Rural Coalition
Land Loss Prevention Project
Intertribal Agriculture Council

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Chapter One
Introduction

In 2022, the Inflation Reduction Act (IRA) became law.[1] The IRA instructs the United States Department of Agriculture (USDA) to help current USDA Farm Service Agency (FSA) Farm Loan Program borrowers that are "distressed borrowers" and that have a farm operation that is "at financial risk."[2] An earlier publication written by Farmers' Legal Action Group (FLAG) described IRA and is still available.[3]

For direct FSA farm loans—which are the subject of this Guide—USDA began by helping distressed borrowers and those whose operations are at financial risk by making payments on the farmer's FSA loans.[4] As of this writing, USDA has made thousands of these payments for many hundreds of millions of dollars of debt.[5]

From the moment IRA became law, an important and confusing part of the Act was the way it affected the federal income tax of farmers that received IRA payments.

The IRA legislation itself does not address the federal income tax effects of the payments. As we noted in the Farmers' Guide to the Inflation Reduction Act, these payments raise important issues for federal income tax since the Internal Revenue Service (IRS) likely thinks that these payments are taxable income for the farmer.

On March 27, 2023, USDA announced it was working with the IRS to help borrowers understand the potential tax effect of an IRA payment and the possibility that for some borrowers there might be ways to avoid or lessen the tax burden from these payments.[6] Then, on April 6, 2023, USDA began sending out letters to some FSA direct loan borrowers notifying them of changes to the way IRA payments should be reported to the IRS. The letter discussed options that may be available "to potentially avoid or alleviate any tax burden incurred as a result of receiving [IRA] financial assistance."[7]

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1 The official title of the IRA is H.R. 5376, "To provide for reconciliation pursuant to title II of S. Con. Res. 14" (August 16, 2022). The important parts of the Act for the purposes of this Guide are at Title I, Subtitle C, Part 2, sections 22006, 22007, and 22008. For the whole Act, see https://www.congress.gov/bill/117thcongress/house-bill/5376/text.

2 IRA section 22006 (August 16, 2022).

3 See Farmers' Legal Action Group, Rural Coalition, Intertribal Agriculture Council, and Land Loss Prevention Project, Farmers' Guide to the Inflation Reduction Act of 2022 (IRA) (September 15, 2022), at http://www.flaginc.org/wp-content/uploads/2022/09/Farmers-Guide-to-Inflation-Reduction-Act-2022-IRA-September-15-2022-1.pdf.

4 Although IRA is designed to help both direct and guaranteed FSA Farm Loan borrowers, the initial payments USDA made on loans were for direct FSA farm loans only.

5 The two best sources for actions taken by USDA are two FSA fact sheets. See FSA, Inflation Reduction Act Section 22006: First Phase of Assistance for Distressed Borrowers (October 2022), at https://www.farmers.gov/sites/default/files/2022-10/farmersgov-fsa-ira-distressed-borrower-assistance-factsheet.pdf; and FSA, Inflation Reduction Act Section 22006: Additional Automatic Payments for Distressed Borrowers (March 2023), at https://www.farmers.gov/sites/default/files/documents/farmersgov-factsheet-ira-22006-additional-automatic-payments.pdf.

6 See FSA, USDA Announces Additional Assistance for Distressed Farmers Facing Financial Risk (March 27, 2023), at https://www.fsa.usda.gov/news-room/news-releases/2023/usda-announces-additional-assistance-for-distressed-farmers-facing-financial-risk.

7 USDA Letter, Changes in Tax Reporting for 2022 Payments Received Under Inflation Reduction Act of 2022 Section 22006 (April 6, 2023).

The changes announced by USDA are important and are likely to help many farmers. They are also confusing. This Guide is intended to give a brief summary of those changes and the effects those changes are likely to have on taxpayers.

This first chapter of the Guide provides some basic suggestions for farmers and describes the rest of the Guide.

I. Expert Tax Advice

The most important message in this Guide is that if an FSA farm loan borrower has received payments as a part of IRA it is extremely important for that farmer to work with a tax expert to understand how IRA payments affect the farmer's federal income taxes.

Federal income taxes are complicated. Federal income taxes for farmers are especially complicated.[8] IRA payments help many farmers, but they also affect the federal income taxes farmers can owe in complicated ways. As will be explained below, changes announced by USDA in March and April 2023 will assist many farmers financially, but they make the farmer's federal income taxes even more complicated.

Further, for many farmers the payments mean the farmer will owe more federal income tax.

This Guide is intended to help farmers and their advocates understand recent changes to the way IRA affects farmer taxes. Except for the rare farmer that is already an expert on federal income tax rules, the only way for a farmer to untangle the confusing effects of the IRA on federal income taxes is to work with a tax expert.

II. IRS Taxpayer Advocate Service

In addition to working with a tax expert, it may be helpful for farmers or their tax experts to contact the IRS Taxpayer Advocate Service. The Taxpayer Advocate Service is a separate part of the IRS that is designed to help people with confusing tax issues. The Taxpayer Advocate Service is likely to be especially helpful to people that may need to amend an already filed tax return. This is how the Taxpayer Advocate Service describes its role:

> We're here to ensure that every taxpayer is treated fairly and that you know and understand your rights. Our advocates can help if you have tax problems that you can't resolve on your own.[9]

The IRS Taxpayer Advocate Service website is here: https://www.taxpayeradvocate.irs.gov/.

III. What This Guide Does and Does Not Cover

This Guide takes a brief look at some of the issues that farmers who benefit from the IRA will face. There are several ways that the IRA might affect farmers that are not covered in the Guide.

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8 For a helpful IRS summary, see IRS Publication 225, Farmer's Tax Guide, For Use in Preparing 2022 Returns (2023), at https://www.irs.gov/pub/irs-pdf/p225.pdf.

9 Taxpayer Advocate Service (2023) is at https://www.taxpayeradvocate.irs.gov/.

A. Only Assistance to Distressed Borrowers and Operations at Financial Risk

This Guide discusses the tax effects of IRA assistance for FSA Farm Loan borrowers that are financially distressed and whose operations are at financial risk.

It does not address other programs in IRA that may affect a farmer's income taxes. For example, it does not address the discrimination financial assistance that is included in IRA.[10]

B. Only Covers Direct Loans—Does Not Cover Guaranteed Loans

FSA makes direct loans. For these loans, it is FSA that is lending to the farmer. FSA also makes guaranteed loans in which a lender, such as a bank or a lender in the Farm Credit System, makes a loan to the farmer, and FSA guarantees that loan for the lender.

This Guide looks only at the ways IRA, and the changes announced by USDA in March and April 2023, affect FSA Farm Loan Program direct loan borrowers. This Guide does not discuss the ways IRA affects federal income taxes for guaranteed FSA loans. Guaranteed loan borrowers have benefited from IRA, but the rules for how IRA works for guaranteed loans are quite different from how they work for direct loans. In addition, the USDA announcements made in March and April of 2023 affect direct loans only. The changes do not affect FSA guaranteed loans. A future FLAG Farmers' Guide will discuss IRA and guaranteed loans.

C. Only Federal Income Taxes—Not State Income Taxes

Changes announced by USDA in March and April 2023 affect federal income taxes. They do not affect state income taxes. Many states have their own income taxes. These state taxes may be affected indirectly by the farmer's federal income taxes. This Guide does not look at that possibility.

D. Only IRA Payments Made in 2022

This Guide offers information that is directly applicable to farmers who received IRA payments in 2022.

USDA has recently announced that it will continue to provide assistance to distressed borrowers with FSA direct farm loans in 2023.[11] Many, but not all, of the discussions in this Guide will also be important for those who receive IRA benefits in 2023. A future FLAG Farmers' Guide will discuss 2023 IRA payments.

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10 Discrimination Financial Assistance is discussed in the Farmers' Guide to the Inflation Reduction Act (IRA). See also, IRA section 22007 (August 16, 2022).

11 USDA, Inflation Reduction Act Assistance for Distressed Borrowers, Additional Assistance for Distressed Borrowers (April 13, 2023), at https://www.farmers.gov/inflation-reduction-investments/assistance; USDA, Press Release No. 0067.23, USDA Announces Additional Assistance for Distressed Farmers Facing Financial Risk (March 27, 2023), at https://www.usda.gov/media/press-releases/2023/03/27/usda-announces-additional-assistance-distressed-farmers-facing.

IV. An Outline for This Guide

This Farmers' Guide to Changes in Taxation of Inflation Reduction Act (IRA) Loan Payments is intended to explain recent developments in the way the IRS is treating IRA payments by looking at several topics.

Chapter Two of the Guide briefly describes the loan payments that are a part of IRA and are the reason for the federal income taxes some farmers will owe.

Chapter Three describes how federal income tax law treats IRA payments.

Chapter Four looks at the importance of what is known as IRS Form 1099 when it comes to the federal income taxes for farmers.

Chapter Five describes how changes announced by USDA in March and April 2023 might affect farmers and their federal income taxes, and the options farmers impacted by these changes have going forward. It is important to emphasize that the effect of the changes will vary from farmer to farmer.

Chapter Six describes briefly how farmers can get involved in the implementation of IRA.

V. Current as of April 17, 2023

This Guide is current as of April 17, 2023. We have relied on information available at that time. It is possible that the situation for IRA, its effect on farm income taxes—and therefore farmers themselves—could change.

VI. Future Farmers' Guides to the IRA

A Farmers' Guide to the Inflation Reduction Act (IRA) was published on September 15, 2022.[12] We plan on creating a revised version of that Guide that will be available soon.

In addition, as we know more about the federal income tax situation for farmers that are a part of IRA, we will update this Guide with a second edition.

VII. Collaborative Effort

This Guide is a product of a collaborative effort by FLAG and Rural Coalition, with support from the W.K. Kellogg Foundation. The Guide was also written in collaboration with Rural Coalition, Land Loss Prevention Project, the Intertribal Agriculture Council (IAC), and others.[13]

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12 See FLAG et al, Farmers' Guide to the Inflation Reduction Act (IRA) (September 15, 2022). It can be found here: http://www.flaginc.org/2022/09/farmers-guide-to-inflation-reduction-act-2022-ira-september-15-2022/.

13 FLAG is at http://www.flaginc.org/. Rural Coalition is at https://www.ruralco.org/. Land Loss Prevention Project is at https://www.landloss.org/. Intertribal Agriculture Council is at https://www.indianag.org/. The W. K. Kellogg Foundation is at https://www.wkkf.org/.

Chapter Two
IRA and USDA Payments on Farmer FSA Debt

I. Introduction

The federal income tax changes announced by USDA in March and April of 2023 have their origin in the Inflation Reduction Act (IRA). This Chapter describes briefly how IRA payments work. An earlier publication published by Farmers' Legal Action Group (FLAG) and others describes the IRA. [14] It is still available.

II. IRA and Payments for FSA Farmer Debts

The IRA became law on August 16, 2022.[15] It gives USDA's Farm Service Agency (FSA) 3.2 billion dollars to make payments on the FSA debt of farmers and to make loan modifications of the FSA debt. This is to be done for farmers that are "distressed borrowers" and farm operations that are at "financial risk."[16]

III. Direct and Guaranteed Loans

Under the IRA, FSA has made payments on both direct and guaranteed loans. In general, IRA payments on direct loans were made directly to the borrower's FSA loan account. For guaranteed loans, FSA sent the money directly to the borrower.

Because the recent changes to how IRA payments are treated for federal tax purposes do not affect IRA payments on guaranteed loans, the focus of this Guide is on direct FSA loans.[17]

IV. Significant Payments Made Under IRA in 2022 and 2023

IRA became law on August 16, 2022. As of this writing, FSA has made thousands of IRA payments for many hundreds of millions of dollars of debt.[18]

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14 That Guide provides more detail. See Farmers' Legal Action Group, Rural Coalition, Intertribal Agriculture Council, and Land Loss Prevention Project, Farmers' Guide to the Inflation Reduction Act of 2022 (IRA) (September 15, 2022), at http://www.flaginc.org/wp-content/uploads/2022/09/Farmers-Guide-to-Inflation-Reduction-Act-2022-IRA-September-15-2022-1.pdf.

15 The official title of the IRA is H.R. 5376, "To provide for reconciliation pursuant to title II of S. Con. Res. 14" (August 16, 2022). For more information, see FLAG, Farmers' Guide to IRA (2022).

16 IRA section 22006 (August 16, 2022).

17 USDA, Inflation Reduction Act Assistance for Distressed Borrowers, Additional Assistance for Distressed Borrowers (April 13, 2023), at https://www.farmers.gov/inflation-reduction-investments/assistance; USDA, Press Release No. 0067.23, USDA Announces Additional Assistance for Distressed Farmers Facing Financial Risk (March 27, 2023), at https://www.usda.gov/media/press-releases/2023/03/27/usda-announces-additional-assistance-distressed-farmers-facing. See also FLAG, Farmers' Guide to IRA (2022).

18 Good sources for USDA payments are two FSA fact sheets. See FSA, Inflation Reduction Act Section 22006: First Phase of Assistance for Distressed Borrowers (October 2022), at https://www.farmers.gov/sites/default/files/2022-10/farmersgov-fsa-ira-distressed-borrower-assistance-factsheet.pdf; and FSA, Inflation Reduction Act Section 22006: Additional Automatic Payments for Distressed Borrowers (March 2023), at https://www.farmers.gov/sites/default/files/documents/farmersgov-factsheet-ira-22006-additional-automatic-payments.pdf.

A. Calendar Year of Payments Matters

The calendar year in which IRA payments are makes a significant difference for federal income tax purposes. The year payments are made by FSA also matters as farmers respond to FSA's recent announcement that there are changes to how IRA payments should be reported on farmers' federal taxes.

B. 2022 IRA Payments

FSA began to make payments under IRA in 2022. As of October 22, 2022, when FSA issued an IRA Fact Sheet that discussed what FSA called a first phase of assistance under the IRA, USDA had made about 800 million dollars of payments to the FSA farm loan accounts to more than 13,000 borrowers.[19]

C. 2023 IRA Payments

In 2023 payments are to be made for many more farmers.[20]

V. IRS Changes to Tax Forms for IRA Payments

As noted in the introduction of this Guide, FSA recently made important announcements concerning the taxation of IRA debt payments.[21] On March 27, 2023, USDA announced that it was exploring the possibility of reducing the tax consequences for farmers that received IRA payments in 2022.[22] Then, on April 6, 2023, FSA began sending out letters to some FSA direct loan borrowers. These letters notified borrowers of changes in the way IRA payments would be reported to the IRS and to FSA borrowers. The letter also discussed options that may be available "to potentially avoid or alleviate any tax burden incurred as a result of receiving [IRA] financial assistance."[23] FSA is posting information and updates on these changes to it's website.[24]

In early 2023, FSA sent farmers who received IRA benefits a Form 1099-G. That form suggests that the payments farmers received should be considered income, as a government payment, for tax purposes.

FSA's April 6, 2023, letter announced that it will issue a Form 1099-C to those same farmers and

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19 FSA Fact Sheet USDA, Inflation Reduction Act Section 22006: First Phase of Assistance for Distressed Borrowers (October 2022).

20 USDA, Inflation Reduction Act Assistance for Distressed Borrowers, Additional Assistance for Distressed Borrowers (April 13, 2023), at https://www.farmers.gov/inflation-reduction-investments/assistance; USDA, Press Release No. 0067.23, USDA Announces Additional Assistance for Distressed Farmers Facing Financial Risk (March 27, 2023), at https://www.usda.gov/media/press-releases/2023/03/27/usda-announces-additional-assistance-distressed-farmers-facing.

21 Additional information on the tax consequences of IRA payments, including webinars hosted by FSA, can be found at: https://www.farmers.gov/working-with-us/taxes#ira-resources.

22 See FSA, USDA Announces Additional Assistance for Distressed Farmers Facing Financial Risk (March 27, 2023), at https://www.fsa.usda.gov/news-room/news-releases/2023/usda-announces-additional-assistance-for-distressed-farmers-facing-financial-risk.

23 USDA Letter, Changes in Tax Reporting for 2022 Payments Received Under Inflation Reduction Act of 2022 Section 22006 (April 6, 2023).

24 Additional information on the tax consequences of IRA payments, including webinars hosted by FSA, can be found at: https://www.farmers.gov/working-with-us/taxes#ira-resources.

will amend the already-issued Form 1099-G. Most direct loan borrowers that benefited from IRA payments in 2022 have received this letter and amended Forms 1099-G and 1099-C. The changes announced by FSA are important and are likely to help many farmers. They are also confusing. This Guide is intended to give a brief summary of those changes and the effects those changes are likely to have on farmers.

Chapter Three
IRA Payments and Federal Income Tax

I. Introduction

In general, farmers can expect that one way or another payments from the government will be counted as taxable income by the Internal Revenue Service (IRS). There are, however, exceptions to this general rule. This Chapter describes how IRA payments, specifically, can affect a farmer's federal income taxes.

II. IRA Does Not Address Taxes

The Inflation Reduction Act (IRA) created payments for farmers with FSA Farm Loan debt. When Congress passed the IRA, it did not address how IRA payments affect a farmer's federal income tax. That is to say, the IRA did not provide for a separate pot of money to go to the IRS on behalf of the farmer to cover the taxes resulting from the payments, and it did not make the payments tax-free. After IRA passed, members of Congress discussed making the IRA payments not taxable, but that never happened.

III. In General, IRA Payments are Taxable

In general, USDA payments to farmers are what the IRS calls "gross income." Gross income includes all income from various sources.[25] These sources include, for example, payments from typical farm programs.

It was always highly likely that FSA payments on borrower debt would be considered taxable income. All income, however, is not treated exactly the same way by the federal tax code. IRA payments are likely to fall into one of two categories: (1) government payments and (2) cancellation of debt. The difference between these two types of income is especially important for understanding the recent changes made to how the IRS is treating IRA payments from 2022. These types of payments and their differences are discussed briefly below.

A. General Rule: Government Payments are Taxable

Most government agricultural program payments made to farmers are taxable income.[26] For example, if a farmer received COVID-19 relief in the form of CFAP payments from USDA, those payments are taxable.[27]Also taxable are USDA disaster payments.[28] There are some exceptions to this general rule. For example, some conservation cost share payments to farmers, such as the Environmental Quality Incentives Program (EQIP), may not be fully taxable.[29] If IRA loan payments are treated as government agricultural

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25 26 U.S.C. § 61(a); Jacob Mertens, *Law of Federal Income Taxation*, Volume 2, Chapter 11, Cancellation of Indebtedness Income, § 11:3, pages 11-17 to 11-18 (Scott Shimick, ed. 2014).

26 The IRS, in its Farmer's Tax Guide, put it this way: "You must include in income most government payments, such as those for approved conservation practices, livestock indemnity payments, or livestock forage disaster payments whether you receive them in cash, materials, services, or commodity certificates." IRS, Publication 225, Farmer's Tax Guide, page 12 (Oct. 14, 2022), at: https://www.irs.gov/pub/irs-pdf/p225.pdf.

27 These are Coronavirus Food Assistance Program (CFAP) payments. See IRS, Publication 225, Farmer's Tax Guide, pages 3, 15.

28 IRS, Publication 225, Farmer's Tax Guide, page 13.

29 IRS, Publication 225, Farmer's Tax Guide, pages 13-14.

program payments, the IRS is likely to think they are fully taxable. Income that is treated as a government payment is usually reported on the IRS Form 1099-G. IRS Forms 1099 are discussed below.

B. General Rule: Cancellation of Debt is Taxable

In general, if debt is canceled or forgiven, this creates what the IRS calls cancellation of debt.[30] It is also sometimes called "discharge of indebtedness" under federal tax law.[31] For a taxpayer—including a farmer—gross income includes all income that results from a discharge of indebtedness.[32] In other words, a discharge of indebtedness, or debt cancellation, is generally taxable income.

Federal tax law defines indebtedness for the purpose of debt cancellation. The definition is broad. The debt of the taxpayer is any debt for which the taxpayer is liable or debt on property that the taxpayer holds.[33]

The taxation of debt cancellation is complicated and has a number of confusing rules that apply when taxation is considered. These rules allow for some cancellation of debt to not be treated as income. It is then not taxable under federal income tax. If IRA loan payments are treated as debt cancellation it is possible that some, or all, of the payments might not be treated as income by the IRS. For federal tax purposes, debt cancellation is reported on IRS Form 1099-C.

C. The Difference Between Government Payments and Debt Cancellation Can Matter

The difference between income that is treated as a government payment and income that is treated as debt cancellation can matter a great deal. The reason is that, for farmers receiving IRA loan payments, if the payments are considered government payments they will almost certainly be considered income for federal tax purposes. If, however, the IRA payments are considered debt cancellation, it may be that some or all of the payments will not end up as taxable income for the farmer.

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30 IRS, Publication 225, Farmer's Tax Guide, page 16-17. For an IRS explanation of rules related to taxation of debt cancellation, see, IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments (for Individuals) for use in Preparing 2002 Returns (October 27, 2022), at https://www.irs.gov/pub/irs-pdf/p4681.pdf.

31 26 U.S.C. § 61(a)(11); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, page 11-18. Section 61(a) of 26 U.S.C. describes what counts as gross income. It includes discharge of indebtedness. See also 26 U.S.C. § 108; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:1, page 11-2.

32 26 U.S.C. § 61(a)(11). In theory, cancellation of debt is thought to be income because it frees up assets that the borrower was obligated to use to repay his or her debt. Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:1, page 11-2, § 11:5, page 11-31. Debt is any debt for which the taxpayer is liable or debt on property that the taxpayer owns. Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:6, page 11-32; IRS Publication 4681, Canceled Debts, at 4.

33 26 U.S.C. § 108(d)(1)(A)-(B); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:6, page 11-32; IRS, Publication 4681, Canceled Debts, at 4.

IV. IRS Form 1099 and Why it Matters

For many types of income, farmers and other taxpayers will receive a form known as Form 1099. This Form describes the amount of income a person—including a farmer—has received. Taxpayers use the form to fill out their tax forms and figure their federal income tax. The same Form 1099 goes to the IRS. As a result, the IRS knows about the income and knows other information about the income. In general, taxpayers will receive their Form 1099 in January or February the year after the income was received.[34] In other words, a Form 1099 received in January or February of 2023 will describe income received in 2022.

A. Different Kinds of IRS Form 1099s

If a farmer—or any taxpayer—receives a Form 1099 it is important to understand the Form and use it correctly when filing income taxes.

One confusing part of Form 1099 is that there are different kinds of Form 1099 income and the federal tax code has separate and varying rules for each kind.

B. IRS Form 1099-G

In general, if a taxpayer receives a 1099-G in the mail it means that some form of government payment has provided the income to the taxpayer.[35] For the purposes of the IRA, what is important is that if a farmer receives a Form 1099-G, it means that USDA is treating the IRA payment as an agricultural payment. On Form 1099-G there is a specific place to list agricultural payments from the government.[36] In general, the IRS will assume that payments from USDA reported on a Form 1099-G are taxable income.[37]

C. IRS Form 1099-C

In general, if debt is forgiven or discharged for less than the full amount owed, that debt is considered by IRS to be canceled.[38] The amount canceled is the amount of the debt the borrower did not have to pay. Although not always, the amount of canceled debt is generally taxable income. Whether canceled debt is taxable is explained in more detail later in this Guide.

In most cases, when creditors (the person or entity that is owed the debt) cancel a debt, they must send an IRS Form 1099-C to the debtor (the one who owes the debt).[39]

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34 To see the dates when various 1099 Forms are due to the IRS and the taxpayer, see the chart at the bottom of the following IRS website: IRS, General Instructions for Certain Information Returns (2023), at https://www.irs.gov/instructions/i1099gi#en_US_2023_publink1000287056.

35 IRS, Instructions for Form 1099-G (Jan. 2022), at https://www.irs.gov/pub/irs-pdf/i1099g.pdf.

36 IRS, About Form 1099-G, Certain Government Payments (2023), at https://www.irs.gov/forms-pubs/about-form-1099-g; and IRS, Instructions for Form 1099-G (Jan. 2022), at https://www.irs.gov/instructions/i1099g.

37 See IRS, Form 1099-G, Instructions for Form 1099-G, at 2 (2022).

38 IRS information about debt cancellation for individuals is at IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments, at 3 (2022), at https://www.irs.gov/pub/irs-pdf/p4681.pdf.

39 See IRS, Instructions for Forms 1099-A and 1099-C, at 6 (Jan. 2022), at https://www.irs.gov/pub/irs-pdf/i1099ac.pdf.

V. In Summary: Government Income and Debt Cancellation Income

Government income—such as farm program payments—are almost always taxable income. In general, therefore, if a farmer receives a Form 1099-G, income described on the form will almost always be taxable income.

For debt cancellation income, the story is very different. If a farmer receives a Form 1099-C, that will generally mean that the income described on the form is taxable. Often, however, there are important rules that can make all or part of the debt cancellation income not taxable.

The next chapter describes the rules that apply when a farmer receives a Form 1099-C.

Later chapters describe recent changes announced by FSA that might have resulted in farmers receiving amended Form 1099s that they must use for their IRA payments.

Chapter Four
Debt Cancellations: Exceptions and Exclusions

I. Introduction

As explained above, cancellation of debt reported on a 1099-C is generally taxable income.[40] There are, however, important rules that make some debt cancellation not taxable. This Chapter discusses the exceptions and exclusions to the rule that debt cancellation is taxable.

II. In General, Forgiven or Discharged Debt is Canceled Debt

In general, if a debt for which a farmer, or other taxpayer, is personally liable is forgiven or discharged for less than the full amount owed, the debt is considered by the IRS to be canceled.[41] In general, cancellation of a debt generally results in taxable income to the debtor in the amount of debt canceled.[42] For example, if a taxpayer owes a lender 100,000 dollars, and the lender allows the taxpayer to pay 40,000 dollars in full satisfaction of the whole debt, the canceled debt is 60,000 dollars.[43] Similarly, if a farmer signs over a piece of property appraised at 65,000 dollars in full payment of a 73,000 dollar debt, the farmer would likely have 8,000 dollars in debt cancellation income.

III. Exceptions to Debt Cancellation Rule

There are exceptions to the rule that forgiven or discharged debt is canceled.[44] If an exception applies, the debt forgiven is not considered canceled. For tax purposes, these exceptions are applied before exclusions, which are discussed below, are applied. Exceptions also do not reduce the taxpayer's tax attributes. Tax attributes are also discussed below.

A. Gifts

If a debt is forgiven as a result of a gift, it is not considered debt cancellation.[45] If FSA payments under IRA were technically a gift, therefore, they would not count as a debt cancellation and the debt forgiveness would not be taxable. It is the taxpayer's burden in court to show that the debt forgiveness was intended as a gift.[46]

In general, a payment is a gift if it is made without conditions and is from a detached and disinterested generosity, out of affection, respect, charity, or similar impulses.[47] It must not be based on a constraining force of any moral or legal duty and not be based on an incentive of anticipated benefits of an economic nature.

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40 See, as well, 7 A.L.R.2d 871, Income Tax: Cancellation of Debt Upon Payment of Less Than Amount Due, or Purchase by Debtor of Own Obligation at a Discount, as Creating Taxable Income, at 1.

41 IRS Publication 4681, Canceled Debts, at 3.

42 IRS Publication 4681, Canceled Debts, at 3; 26 U.S.C. § 61(a)(11).

43 IRS Publication 4681, Canceled Debts, at 3.

44 IRS Publication 4681, Canceled Debts, at 3-4.

45 Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:7, pages 11-47 to 11-48; IRS Publication 4681, Canceled Debts, at 4.

46 The burden is on the taxpayer to show that the creditor intended a gratuitous forgiveness of debt. Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:7, page 11-47 to 11-48. As a result, the lack of evidence of consideration does not necessarily mean something is a gift.

47 Black's Law Dictionary (6th ed. 1990). As the IRS explains, in most cases taxpayers do not have income from a canceled debt if the debt is a gift. IRS Publication 4681, Canceled Debts, at 4.

The law regarding what counts as a gift is confusing.[48] We have located no authority from the IRS or other sources that suggests IRA payments should be considered a gift for tax purposes. Nor have we seen information suggesting directly that IRA payments definitely are not a gift. Farmers may want to consult tax experts regarding whether government payments under IRA might count as a gift.

B. Deductible Debt

No income is realized from the cancellation of a debt if it is considered to be an income tax deductible debt.[49] A deductible debt is a debt that is a deductible expense if it is paid. A number of rules apply when deciding if a debt is deductible as a business expense.[50]

In general, farmers can include farm business interest that is paid by the farmer as a deduction.[51] This can include, for example, interest from a farm mortgage or other farm debts.

IV. Exclusions to Debt Cancellation Income

In general, as noted above, cancellation of debt creates taxable income. Despite this general rule, there are times when the cancellation of debt does not create taxable income.[52] These circumstances are called exclusions. If an exclusion applies, this means that cancellation of debt occurred. That cancellation, however, does not create income for the taxpayer as would usually happen. Instead, part or all of the debt cancellation will not be counted as income.

Several exclusions to the general rule that debt cancellation creates taxable income are discussed in the following sections. Specifically, five exclusions are discussed: (1) insolvency of the debtor;

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48 The various interpretations of gifts and debt cancellation are discussed in 7 A.L.R.2d 871, at 5-7. Courts have often thought that it is the creditor's donative intent that is the determining factor in deciding if there is a gift. Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:7, page 11-47. Donative means the conveyance was made with a detached and disinterested generosity. Put differently, for discharged debt to be considered a gift and not a discharge of debt that results in income, the creditor must have intended to release the debt under a gratuitous release. Further, if a debt is forgiven out of a perceived moral or legal duty, the forgiveness will count as a taxable debt cancellation. Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:7, page 11-48; *Cook v. United States*, 897 F. Supp 1403, 1407 (M.D. Florida, 1995). In the case of IRA payments, some aspects of the payment seem like a gift. For example, the farmer does not need to do anything in exchange for the IRA payment. If, for example, in exchange for the IRA payment, the FSA borrower had to promise to pay some of the debt back in the future if the farmer became wealthy over time, that would make the IRA payments look less like a gift.

49 26 U.S.C. § 108(e)(2); IRS, Publication 4681, at 5-6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:9, page 11-49.

50 For example, see IRS, Publication 225, Farmer's Tax Guide, at 20-22.

51 IRS, Publication 225, Farmer's Tax Guide, at 22; IRS, Publication 535, Business Expenses, Chapter 4 (Feb. 2, 2023), at https://www.irs.gov/pub/irs-pdf/p535.pdf. For large-scale farmers this can be a complex calculation. See IRS, About Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), at https://www.irs.gov/forms-pubs/about-form-982; IRS, Basic Questions and Answers About the Limitation on the Deduction for Business Interest Expense, at https://www.irs.gov/newsroom/basic-questions-and-answers-about-the-limitation-on-the-deduction-for-business-interest-expense.

52 26 U.S.C. § 108; IRS, Publication 4681, Canceled Debts, at 6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:10, page 11-55.

(2) qualified farm indebtedness; (3) bankruptcy; (4) qualified real property business indebtedness; and (5) qualified principal residence indebtedness. The two most likely exclusions to apply to farmers who received payments under the IRA are the insolvency of the debtor and qualified farm indebtedness.[53]

Using exclusions to the general debt cancellation rule can be complicated. Consult a tax expert regarding your specific circumstances.

A. Insolvency Exclusion

An exclusion to the general rule that debt cancellation is taxable is possible if the debtor is insolvent.[54]

1. Defining Insolvent

A debtor is insolvent if the debtor's debts are more than the value of the debtor's assets.[55] To make this comparison, several rules apply. First, all of the taxpayer's liabilities are included in the comparison.[56] Second, assets are considered at the fair market value.[57] Third, both numbers are calculated as of the time right before the debt cancellation.[58]

Analyzing insolvency can be confusing. The calculating assets can be different from legal asset calculations, such as those used in bankruptcy, and liability calculation may not match state law exemptions in debtor-creditor law.

2. Amount Excluded from Taxation

The level of possible debt cancellation that is excluded from gross income will vary depending on the extent to which the taxpayer is insolvent.[59] An insolvent debtor can generally exclude debt-cancellation income from gross income up to the amount of the debtor's debts. Excluded income cannot be more than the amount by which the farmer is insolvent. If the discharge of indebtedness makes the borrower no longer insolvent, the taxpayer may then owe some in taxes. That tax would be on the amount of discharge that was more than enough to lift the borrower out of insolvency.

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53 On April 7, 2023, FSA hosted a webinar describing the recent taxation changes to IRA payments. The webinar goes into some detail on the insolvency and qualified farm indebtedness exclusions. The webinar can be viewed at https://www.youtube.com/watch?v=zxXPtp4UJ6Y.

54 26 U.S.C. § 108(a)(1)(B); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:11, page 11-58; IRS Publication 4681, Canceled Debts, at 6.

55 26 U.S.C. § 108(d)(3); IRS, Publication 4681, Canceled Debts, at 6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:11, page 11-58.

56 IRS Publication 4681, Canceled Debts, at 6. Special rules apply for nonrecourse debts. For farmers with CCC loans this could be a part of the calculation since CCC loans can be nonrecourse loans.

57 Assets include the value of everything the taxpayer owns. This includes, for example, any collateral that was used for the canceled debt, assets that would be exempt under state law from a judgment, and pension plans and retirement accounts. See IRS Publication 4681, Canceled Debts, at 6.

58 26 U.S.C. § 108(d)(3); See IRS, Publication 4681, Canceled Debt, at 6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:11, page 11-58.

59 26 U.S.C. § 108(a)(1)(B), (a)(3); See IRS, Publication 4681, Canceled Debt, at 6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:11, pages 11-58 to 11-59.

3. Worksheet and Examples

The IRS provides a worksheet to calculate insolvency for the purpose of debt cancellation exclusions.[60] The IRS also provides examples for how the insolvency exclusion works.[61]

B. Qualified Farm Indebtedness Exclusion

An exclusion to debt cancellation tax liability can occur if the debt is qualified farm indebtedness.[62]

1. Effect of the Qualified Farm Indebtedness Exclusion

A debt cancellation exclusion applies for what is called qualified farm indebtedness. [63] If the debt that is canceled is qualified farm indebtedness the income from debt cancellation that would otherwise be included in the taxpayer's gross income is not included.[64]

2. When Qualified Farm Indebtedness Exclusion Applies

Two important things must be true for the qualified farm indebtedness exclusion to apply.

a. Debt Incurred in Connection with Farming

To be qualified farm indebtedness, the debt must be directly connected to the operation by the taxpayer of the trade or business of farming.[65]

b. Gross Receipts from Farming

IRS rules allow only certain farmers to claim the qualified farm indebtedness exclusion.

For the exclusion to apply, at least 50 percent of farmer's gross receipts for three years preceding the year in which the discharge took place must have been from

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[60] IRS Publication 4681, Canceled Debts, at 7.

[61] IRS Publication 4681, Canceled Debts, at 6.

[62] 26 U.S.C. § 108(a)(1)(C), (g)(2); IRS Publication 4681, Canceled Debts, at 8; 11:3, page 11-21; IRS Publication 225, Farm Income, at 18; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, pages 11-18, 11-21, § 11:12, page 11-60.

[63] 26 U.S.C. § 108(a)(1)(C), (g)(2); IRS, Publication 4681, Canceled Debts, at 8; IRS Publication 225, Farmer's Tax Guide, at 18; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, pages 11-18, 11-21, § 11:12, page 11-60. The debt must be canceled by what the IRS calls a "qualified. person." See 26 U.S.C. § 108(g)(1). USDA counts as a qualified person for the qualified farm indebtedness exclusion. See 26 U.S.C. § 108(g)(1)(B); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:12, page 11-61.

[64] 26 U.S.C. § 108(a)(1)(C); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, pages 11-18, 11-21.

[65] 26 U.S.C. § 108(g)(2)(A); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:12; page 11-61; IRS Publication 4681, Canceled Debts, at 8.

the trade or business of farming.[66] For IRA payments made in 2022, this means that at least 50 percent of a farmer's combined total gross receipts from 2019, 2020, and 2021 must have come from the trade or business of farming. For a farmer paying taxes on 2023 income, those years would be 2020, 2021, 2022.

The farmer does not need to have been engaged in farming in each of the three preceding years in order to meet this requirement. If the farmer did not farm for any of those three years, the fifty percent requirement could not be met. Renting out farmland does not count as a gross receipt from the trade or business of farming.[67] Sale of inventory or capital assets from the trade or business of farming or its termination is considered gross income from farming.

3. Other Complicated Rules for Qualified Farm Indebtedness

Several aspects of the qualified farm indebtedness exclusion are complicated and are not discussed in this Guide. Farmers should consult with a tax expert. For example, the amount of the canceled debt excluded from income as qualified farm indebtedness cannot be more than the debtor's adjusted tax attributes and the adjusted basis of the qualified property.[68]

C. Exclusion Due to Bankruptcy

An exclusion to debt cancellation tax liability can occur if the debt was canceled because of a discharge of the debt by a bankruptcy court.[69] An FSA borrower's debt can be discharged in bankruptcy. If that happens, the cancellation can qualify for the bankruptcy exclusion to income. As explained below, however, if the FSA borrower had debt canceled due to an IRA payment, that cancelled debt does not qualify for the bankruptcy exclusion.

1. What is a Bankruptcy Discharge

A bankruptcy court can discharge debts of a person in bankruptcy.[70] That discharge releases the debtor from personal liability for debts, and the debtor is no longer legally required to pay the debt.[71]

2. Bankruptcy Discharges are Excluded from Debt Cancellation Taxation

If the discharge of debt occurs in a bankruptcy court the debt cancellation income that

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66 26 U.S.C. § 108(g)(2)(B); IRS Publication 4681, Canceled Debts, 8 (Oct. 27, 2022); IRS Publication 225, 18 (October 14, 2022); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, §§ 11:3, 11:12, pages 11-18, 11-21, 11-61.

67 Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:12, page 11-61.

68 26 U.S.C. § 108(a)(2)(B), (g)(3); IRS Publication 4681, at 8; IRS Publication 225, at 18; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, §§ 11:3, 11:12, pages 11-18, 11-21, 11-61. Qualified property is property used or held for use in a trade or business or for the production of income. See 26 U.S.C. § 108(g)(3)(C).

69 26 U.S.C. § 108(a)(1)(A); IRS Publication 4681, at 6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:11, page 11-57.

70 11 U.S.C. §§ 524, 727; Henry J. Sommer, *Consumer Bankruptcy Law and Practice*, National Consumer Law Center, Chapter 2, § 2.2, Chapter 15, § 15.1 (13th ed. 2023).

71 26 U.S.C. § 108(a)(1)(A); IRS Publication 4681, at 6; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:11, page 11-57.

would otherwise be included in the taxpayers' gross income is not included.[72] In order for the debt to be excluded from income, the borrower must be "under the jurisdiction" of the bankruptcy court. In other words, the bankruptcy proceeding must be ongoing. Further, either the discharge must be granted by the bankruptcy court or the bankruptcy court must have approved a plan that includes the discharge of indebtedness.[73] For this exclusion to apply, therefore, the debt must have been canceled as a result of the bankruptcy. It may not have been canceled as a result of IRA.

3. IRA Payment or Bankruptcy Discharge?

A central question for this Guide is whether the forgiveness of the debt was caused by a bankruptcy court or was caused by IRA payments. This could be a confusing question for some farmers. Many farmers have once been in bankruptcy, and some have been in bankruptcy recently. Some of the farmers that were in bankruptcy received IRA payments. A bankruptcy exclusion only applies if the cancellation of the debt was the result of a bankruptcy discharge. So, even if the farmer was recently in bankruptcy, if the debt cancellation of the debt was due to the IRA—and not due to the bankruptcy itself—no exclusion applies for that debt under the bankruptcy exclusion. It is certainly possible that a farmer could have debt discharged in bankruptcy and have received an IRA payment that could qualify for an exclusion. For the purposes of federal income taxes, however, debt cancellation of a debt must be caused by one or the other, or for some other reason. A single debt cancellation cannot be caused both by bankruptcy and an IRA payment.[74]

4. Figuring Out if the Bankruptcy Court Discharged the Debt

A review of bankruptcy documents should show whether the bankruptcy court ordered a certain debt to be canceled.

If the FSA debt was discharged by a bankruptcy court in 2022, the original Form 1099 that the farmer received in early 2023 likely was a Form 1099-C. If the farmer initially received a Form 1099-C it means the FSA thought the cancellation was the result of a bankruptcy ruling and was not the result of IRA. If the farmer received a Form 1099-G in early 2023, and not a Form 1099-C, it almost for sure means that USDA believes the cancellation took place as a part of the IRA and was not the result of a bankruptcy discharge. This would mean that even if the farmer is, or has been, in bankruptcy, FSA believes the cancellation was due to the IRA and not to a bankruptcy.

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72 26 U.S.C. § 108(a)(1)(A); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, page 11-18; §11:11, pages 11-57 to 11:58; IRS Publication 4681, Canceled Debts, at 6.

73 26 U.S.C. § 108(d)(2); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, §§ 11:3, 11:11, 11:18; IRS Publication 4681, Canceled Debts, at 6.

74 26 U.S.C. § 108(a)(2)(A); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, page 11-18. In addition, ff the discharge occurs in a bankruptcy, no other exclusion can be applied.

D. Exclusion for Qualified Real Property Business Indebtedness

Debtors that are not incorporated might not be taxed on the cancellation of "qualified real property business indebtedness."[75] Qualified real property business indebtedness is debt that is taken on in connection with real property used in a trade or business and is secured by that property.[76] Debts taken on after January 1, 1993, will only be considered qualified real property business indebtedness if they were taken on for the purpose of acquiring, constructing, or substantially improving real property.[77]

E. Other Aspects of Exclusion: Tax Attributes and Basis in Property

A confusing aspect of the exclusions for taxation of debt cancellation concerns what are known as tax attributes.[78] In many cases, exclusion of debt cancellation income will require the taxpayer to reduce what the IRS calls tax attributes. In other words, although the taxpayer may get to apply an exclusion, the taxpayer may not be avoiding the tax altogether. Instead, the taxation will have been deferred.[79]

1. Tax Attributes

Tax attributes are confusing and can include a number of different things. They include, for example, the tax basis on property.[80] Basis is important because it is used to decide what taxes are owed if an asset is sold. Tax attributes also include already existing net operation losses (NOL), or a NOL carryover—that is to say, a NOL that is carried over from one year to another.[81]

2. Reducing Tax Attributes

In many cases, a taxpayer using an exclusion for taxation of debt cancellation will need to reduce the taxpayer's tax attributes.[82] This might mean reducing net operating losses (NOL). Because net operating losses reduce taxes, reducing them can increase the taxpayer's taxes. Similarly, if the taxpayer's basis in property is reduced by an exclusion for taxation of debt cancellation, that could mean that if the taxpayer ever

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75 26 U.S.C. § 108(a)(1)(D), (C).

76 26 U.S.C. § 108(c)(3)(A)-(C).

77 26 U.S.C. § 108(c)(3)(B), (C)(4). The amount excluded from the debtor's gross income is generally capped by the amount that the principal owing on the canceled debt exceeds the fair market value of the property securing the debt; 26 U.S.C. § 108(c)(2)(A).

78 A webinar hosted by FSA on April 7, 2023, describes the recent taxation changes to IRA payments, including providing a brief explanation of tax attributes. The webinar can be viewed at https://www.youtube.com/watch?v=zxXPtp4UJ6Y.

79 For a more in-depth explanation of the interaction between debt cancellation and tax attribute, see Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:14, pages 11-64 to 11-71.

80 26 C.F.R. §§ 1.108-7(a)(1)(v), 1.1017-1; IRS, Publication 4681, Canceled Debts, at 11; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:1, page 11-4, § 11:3, page 11-19, § 11:14, pages 11-65 to 11-71.

81 26 U.S.C. § 108(b)(2)(A); 26 C.F.R. §§ 1.108-7(a)(1)(i), 1.1017-1; IRS, Publication 4681, Canceled Debts, at 11; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:1, page 11-4, § 11:3, page 11-19, § 11:14, pages 11-65 to 11-71.

82 26 U.S.C. § 108(b)(1)-(2); 26 C.F.R. §§ 1.108-7(a), 1.1017-1; IRS, Publication 4681, Canceled Debts, at 11; Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:1, page 11-4, § 11:3, pages 11-19, § 11:14, pages 11-65 to 11-71.

sells the asset in question, taxes on a gain from the sale could be increased.

In some cases, this will mean that the exclusion of discharge of indebtedness really amounts to a delay in taxation. If, however, the farmer's tax attributes or basis in depreciable property are less than the amount of excluded income, the taxpayer may permanently avoid taxation on the excluded income.

3. IRS Form 982

The IRS has a special form for noting debt cancellation and a reduction in tax attributes—IRS Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness.[83] Form 982 explains some details as to how the reduction of attributes works, and must be filed with the IRS if a debt cancellation exclusion is used.

4. Tax Attribute Reduction is Confusing: Get Expert Advice

The rules regarding the reduction of tax attributes is confusing. Not every exclusion affects tax attributes in the same way, and understanding the exact way that tax attributes are reduced is especially confusing.

Farmers who have benefited from IRA payments and are hoping to use exclusion of income for debt cancellation should consult a tax expert to help understand the rules for tax attributes.

F. Entities: Partnerships and Corporations

In general, the rules for excluding debt cancellation income affects both individuals and entities in similar ways. There are differences, however, especially for partnerships and certain corporations.[84] Farmers using an entity should consult a tax expert.

G. How Different Exclusions Interact

Some taxpayers will be eligible for more than one type of exclusion on tax liability for debt cancellation. Complicated rules set out when certain exclusions take precedence over others.[85] Farmers should consult a tax expert for assistance in understanding how exclusions interact.

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83 IRS, Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)(2023), at https://www.irs.gov/pub/irs-pdf/f982.pdf; and IRS, Instructions for Form 982 (2023), at https://www.irs.gov/pub/irs-pdf/i982.pdf. See also, IRS, About Form 982, Reduction of Tax Attributes to discharge Indebtedness (and Section 1082 Basis Adjustment) (February 14, 2023), at https://www.irs.gov/forms-pubs/about-form-982.

84 See 26 U.S.C. § 108(d)(6)-(7); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, page 11:23, §§
11-15 to 11:17, pages 11-71 to 11-79.

85 See, for example, 26 U.S.C. § 108(b)(4); Mertens, *Law of Federal Income Taxation*, Vol. 2, Ch. 11, § 11:3, pages 11-18 to 11-19, § 11:11, page 11-57; IRS Publication 4681, Canceled Debts, at 6-12.

Chapter Five
Going Forward

I. FSA Changes to Forms 1099

As explained in this Guide, in most cases, farmers who received IRA payments from FSA in 2022 would have received a Form 1099-G in early 2023. This Form 1099-G is a tax form that reflects the financial assistance farmers received from government payments—in this case, payments from FSA under the IRA. Then, in early April 2023, FSA mailed letters to certain FSA direct loan borrowers that included a different tax form, Form 1099-C. Form 1099-C reports cancellation of debt. If a farmer who initially received a Form 1099-G from FSA later received a letter with Form 1099-C attached, it means that the way the farmer must report their IRA payments has changed. For some farmers, this also means that they will receive a new, revised 1099-G for 2022.[86]

As was discussed earlier in this Guide, the difference between a 1099-G and a 1099-C can be very important for farmers, and farmers should consult a tax expert to decide how to proceed. This is especially true because of the potential for a farmer who received a Form 1099-G and then a Form 1099-C could qualify for the exceptions or exclusions discussed earlier in this Guide. If an exception or exclusion applies, it is possible that all, or a part, of the farmer's 2022 IRA payment would not count as taxable income.

II. Amending a Tax Return

Once a farmer—or any other person—files income taxes, it is possible to amend the filing. In other words, it is possible for the farmer to fill out forms that say that a mistake was made on the original filing, and the farmer is therefore filing an amended form.

This is important, especially for farmers who received IRA payments in 2022, filed their 2023 taxes based on information in Form 1099-G that farmers received in early 2023, and then received a Form 1099-C and an amended Form 1099-G.

The information found on Forms 1099-G and 1099-C is reported to the IRS on an individual's Form 1040—and for farmers, the 1040 Schedule F. It therefore might be necessary for a farmer to amend a filed Form 1040 if the farmer received additional Forms 1099 from USDA in April 2023. As the IRS explains, "If you discover an error after filing your return, you may need to amend the return."[87] The IRS suggests that taxpayers file an amended return if there is a change to the taxpayer's income, deduction, or tax liability. If a farmer has filed one of the 1040 forms, an amendment to it should be made with a Form 1040-X.[88] IRS materials explain how this is done and the forms to use.[89]

For taxpayers claiming a refund or credit, Form 1040-X must be filed within three years after

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[86] See USDA, Tax Resources for Recipients of Inflation Reduction Act Assistance, at https://www.farmers.gov/working-with-us/taxes#ira-resources.
[87] IRS, Topic No. 308, Amended Returns (2023), at https://www.irs.gov/taxtopics/tc308.
[88] IRS, Topic No. 308, Amended Returns (2023).
[89] IRS, About Form 1040-X, Amended U.S. Individual Income Tax Return (2023), at https://www.irs.gov/forms-pubs/about-form-1040x.

the date the original return was filed, or within two years after the date the taxes were paid—whichever is later.[90]

For some farmers, the change in approach for Forms 1099 may not change taxes owed. If the farmer does not wish to amend tax forms, in this case there is no reason why an amendment would be required.

III. Declining IRA Payments

Some farmers might decide they would rather not have received IRA payments on their debt. FSA says that if a borrower wishes to decline the IRA payments the farmer may do so. The FSA debt that was paid would be reinstated by FSA. Farmers should consult a tax expert before doing so. For most farmers, on a purely financial basis, there is an advantage to accepting the payments even if the farmer owes taxes as a result. There may not be a financial advantage for every farmer. In addition, the farmer may have reasons other than financial to decline the payments.

IV. Paying a Tax Bill in Installments

It is possible that a person of modest means could end up with significant income in a single year and suddenly have a large federal tax bill for a single year. This could happen, for example, if a farmer received a large pay-off on a debt and that payoff is taxable. That scenario is certainly possible for a farmer who received an IRA payment. It is easy to imagine, for example, that a farmer could receive debt cancellation of one hundred thousand dollars in a single year, and might have an increase in a tax bill of several tens of thousands of dollars without any extra cash income.

In this sort of case, it would seem the farmer's only options for payment are to sell something of value, pay the bill with a credit card, or maybe borrower money to pay the taxes.

Another possibility is that the IRS will allow a taxpayer to stretch out payments over a longer period. It is not clear that this is an especially good arrangement for the farmer, but it might be better than the alternatives.

The IRS calls the ability to stretch out payments an Installment Agreement, or Payment Plan.[91]

The sections below explain this possibility. The rules below apply only to individual farmers, sole proprietors, and independent contracts—there are different rules for businesses.[92] Farmers interested in an Installment Agreement should consider speaking with a tax expert to better understand the financial implications of stretching out their IRS payments.

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90 IRS, Topic No. 308, Amended Returns (2023). For purposes of calculating this deadline, if a farmer filed an original return early (for example, March 1), that return is considered filed on the due date (generally April 15). See IRS, Instructions for Form-1099-X, When to File (2023), at https://www.irs.gov/instructions/i1040x.

91 See IRS, Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018), available at: https://www.irs.gov/pub/irs-pdf/p594.pdf.

92 For the Installment Agreement rules applicable to businesses, see IRA, Apply Online for a Payment Plan, Business Payment Plan?, at https://www.irs.gov/payments/online-payment-agreement-application.

A. Definition of an Installment Agreement

An installment agreement with IRS is a legally binding contract. It allows the taxpayer to make payments over an extended period of time until the farmer has paid the entire amount due. Interest and penalties, however, will still continue to be charged until the farmer pays the balance in full.[93]

B. Types of Installment Plans

There are two types of installment plans—short-term and long-term plans. To be eligible for either, a farmer must have filed all required tax returns.[94]

1. Short-Term Payment Plans—180 Days or Less

A short-term payment plan is a plan that extends out payments for 180 days or less.[95]

2. Long-Term Payment Plans—More than 180 Days

Long-term payment plans are Installment Agreements with monthly payments extending for a period of over 180 days.[96]

C. Applying for an Installment Agreement/Payment Plan

A taxpayer can apply for a payment plan online, by phone, by mail, or in person at their local IRS office. The least expensive way to apply for an Installment Agreement is online.[97] As described below, however, not all farmers will be eligible to apply online.

1. Online

To apply for an Installment Agreement online, a farmer can visit www.irs.gov/OPA. Not all farmers will be able to apply online.[98] To be eligible to apply online for a short-term payment plan of 180 days or less, the farmer must owe less than $100,000 in combined tax, penalties, and interest.[99] In order to apply online for a long-term

93 See IRS, Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018), available at: https://www.irs.gov/pub/irs-pdf/p594.pdf. For additional information on the penalties and interest that are charged when a person receives a federal tax bill, see IRS, Notice 746, Information About Your Notice, Penalty, and Interest, at: https://www.irs.gov/pub/irs-pdf/n746.pdf.

94 IRS, Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018).

95 IRS, Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018); IRA, Apply Online for a Payment Plan, Do you qualify?, at https://www.irs.gov/payments/online-payment-agreement-application.

96 IRS, Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018); IRA, Apply Online for a Payment Plan, Do you qualify?, at https://www.irs.gov/payments/online-payment-agreement-application.

97 The IRS can charge higher setup fees for applications submitted by phone, mail or in-person. For more information on applying for an Installment Agreement, see IRA, Apply Online for a Payment Plan, at https://www.irs.gov/payments/online-payment-agreement-application.

98 The IRS also has an instructional video that briefly explains how to fill out the Online Payment Agreement application. The instructional video can be found at: https://www.irsvideos.gov/Business/FilingPayingTaxes/AvoidingInterestAndPenaltyCharges

99 IRA, Apply Online for a Payment Plan, Do you qualify?, at https://www.irs.gov/payments/online-payment-agreement-application.

Installment Agreement, the farmer must owe $50,000 or less in combined tax, penalties, and interest, and the farmer must have filed all of their required tax returns.[100]

2. By Phone

To apply for an Installment Agreement by phone, a farmer can call either the phone number listed on their IRS bill or 1-800-829-1040.[101]

3. By Mail

To apply for an Installment Agreement by mail, farmers should complete IRS Form 9465, Installment *Agreement Request*, and mail the form to the address listed on the farmer's IRS bill.[102]

4. In Person

To apply for an Installment Agreement in person, farmers should visit their local IRS office.[103]

D. Setup Fees, Interest, and Penalties

If a farmer chooses to apply for an Installment Agreement with the IRS, there can be setup fees, interest accrual, and other penalties involved.[104] This often depends on how long the farmer extends out the payments under the plan, as well as how much the farmer owes the IRS in total. Some farmers who qualify as low-income taxpayers may be eligible for reduced fees.

The IRS has also created a video that summarizes the potential penalties and interest accrued when taxes are not paid on time.[105] Farmers should look closely at the various options. As the IRS video explains, the interest and penalties involved in an Installment Payments could be greater than what would be charged by a bank loan or credit card company.

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[100] IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018); IRA, Apply Online for a Payment Plan, Do you qualify?, at https://www.irs.gov/payments/online-payment-agreement-application.

[101] IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018).

[102] IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018). A copy of Form 9465 can be downloaded at : https://www.irs.gov/pub/irs-prior/f9465--2020.pdf

[103] IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018). To find the closest IRS office, visit https://apps.irs.gov/app/office-locator/.

[104] See generally, IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018), available at: https://www.irs.gov/pub/irs-pdf/p594.pdf.

[105] The instructional video can be found at: https://www.irsvideos.gov/Business/FilingPayingTaxes/AvoidingInterestAndPenaltyCharges

1. Costs Involved with Short-Term Payment Plans

For short-term payment plans of 180 days or less, the IRS will not charge a setup fee.[106] However, interest will accrue and other penalties will be charged until the balance is paid in full.[107]

If a farmer enters into a short-term payment plan, the amount due can be paid directly from the farmer's checking or savings account, or by check, money order, or debit/credit card.[108] The IRS will charge an additional fee if a farmer pays using a card. Any farmer who owes the IRS over $25,000 must pay for a payment plan using direct debit.[109]

2. Costs Involved with Long-Term Payment Plans

For long-term payment plans of over 180 days, interest and penalties will accrue until the balance is paid in full.[110] The fees for a long-term plan depend on how the farmer chooses to pay. Set up fees range from thirty-one to 139 dollars.[111] In some cases there can be a fee waiver.

V. Getting Involved and Contact Information

Loan payments on direct farm loans is only one part of the IRA. A number of extremely important parts of the IRA are still to be carried out. Farmers and farmer organizations can play a crucial role in advocating with USDA as to how the IRA should actually be carried out.

Rural Coalition, the Land Loss Prevention Project, the Intertribal Agriculture Council (IAC), and other organizations are working hard both to supply input and recommendations to USDA on implementation and to provide outreach and technical assistance to producers who may be

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[106] IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018); IRA, Apply Online for a Payment Plan, What does it cost?, at https://www.irs.gov/payments/online-payment-agreement-application.

[107] IRS, Additional Information on Payment Plans, What are payment plan costs and fees?, at https://www.irs.gov/payments/payment-plans-installment-agreements#costs.

[108] IRS Publication 594, The IRS Collection Process, at 3 (Rev. 7-2018); IRA, Apply Online for a Payment Plan, What does it cost?, at https://www.irs.gov/payments/online-payment-agreement-application.

[109] IRS, Additional Information on Payment Plans, What are payment plan costs and fees?, at https://www.irs.gov/payments/payment-plans-installment-agreements#costs.

[110] IRS, Additional Information on Payment Plans, What are payment plan costs and fees?, at https://www.irs.gov/payments/payment-plans-installment-agreements#costs.

[111] If a farmer applies for an Installment Agreement online and elects to pay the monthly amount through direct debit (automatic payments from the farmer's checking account) the setup fee is $31 dollars. IRS, Additional Information on Payment Plans, What are payment plan costs and fees?, at https://www.irs.gov/payments/payment-plans-installment-agreements#costs. For farmers who apply by phone, mail, or in-person, the setup fee is $107. For some low-income farmers that fee is waived. For more information about who qualifies as a low-income taxpayer, visit https://www.irs.gov/payments/payment-plans-installment-agreements#feewaiver. See also IRS Form 13844, Application for Reduced User Fee for Installment Agreements, available for download at: https://www.irs.gov/pub/irs-pdf/f13844.pdf. Any farmer who owes the IRS over $25,000 must pay for a payment plan using direct debit. If the farmer applies for an Installment Agreement online and chooses to pay the monthly fee by check, money order, debit/credit card, or directly from a checking account (but not an automated direct debit) the setup fee is $130. For farmers who apply by phone, mail, or in-person, the setup fee is $225. The setup fee is reduced to $43 if the farmer qualifies as a low-income taxpayer.

eligible for relief under IRA. Please contact them to stay informed of opportunities and to take part in that work.

Rural Coalition - Contact Lorette Picciano (lpicciano@ruralco.org) and Kenesha Reynolds (Kenesha@ruralco.org), or see https://www.ruralco.org

Land Loss Prevention Project - Contact Savi@landloss.org or llppinfo@landloss.org, or see http://www.landloss.org.

Intertribal Agriculture Council - Contact iac@indianag.org, or see www.indianag.org.

Farmers' Legal Action Group, Inc. (FLAG) – FLAG can be reached at (651) 223- 5400 or toll-free (877) 860-4349. The website is http://www.flaginc.org. Contact Stephen Carpenter at scarpenter@flaginc.org and Lindsay Kuehn at lkuehn@flaginc.org.

Chapter Six
Conclusion

We conclude this Guide with three central points.

I. Changes to the Taxation of IRA Debt Payments Can be Significant

Most farmers that receive payments on their direct loans due to IRA will benefit significantly from those payments. The IRA payments do, however, often create income for federal income tax purposes. Recent changes by FSA to the way IRA payments are reported to farmers and to the IRS can help many farmers reduce or remove the federal income taxes that will be owed due to IRA payments.

II. Get Expert Tax Advice

The most important suggestion from this Guide is that farmers dealing with federal income tax issues created by IRA payments need expert tax advice.

Every part of the discussion of federal income taxes in this Guide is complicated. First, federal income tax is complicated in general. Income tax for farmers is more complicated than taxes for most other taxpayers. Second, although IRA payments on direct FSA loan debt—possibly a form of debt cancellation in the eyes of the IRS—can be of help to farmers, it generally creates federal income tax liability that itself is complicated. Finally, although there are ways by which some farmers will be able to avoid or minimize federal income taxes due to IRA payments, these strategies are themselves complicated.

The only way to deal carefully and accurately with the federal income taxes and IRA payments is to get expert tax advice.

III. Getting Involved

Many important decisions about IRA are still being made by FSA.[112] Farmers can get involved in helping to shape the IRA by contacting the organizations listed at the end of Chapter Five.

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[112] For a summary of what IRA does, see FLAG et al, Farmers' Guide to the Inflation Reduction Act (IRA) (September 15, 2022). It can be found here: http://www.flaginc.org/2022/09/farmers-guide-to-inflation-reduction-act-2022-ira-september-15-2022/.