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Office of Inspector General
Southwest Region
Audit Report

Farm Service Agency
Payment Limitation Review of a Joint Venture in Bryan County, Oklahoma

Report No.
03099-26-Te
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UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Southwest Region - Audit
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DATE: June 23, 2000

REPLY TO
ATTN OF: 03099-26-Te

SUBJECT: Payment Limitation Review in Bryan County, Oklahoma

TO: Terry L. Peach
State Executive Director
Oklahoma State Farm Service Agency
100 USDA, Suite 102
Stillwater, OK 74074-2653

This report presents the results of the subject audit. Your written response to the draft report is included as exhibit E. Excerpts from the written response along with the Office of Inspector General's position have been incorporated into the relevant sections of the report.

Based on your response, management decisions have not been reached for Recommendations Nos. 1 and 2. The information needed to reach agreement is set forth in the Recommendations section of the report. In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing corrective actions taken or planned and the timeframes for implementation for all recommendations. Please note that the regulation requires management decisions to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

We appreciate the cooperation and assistance provided during the audit.

/s/John O. Leavy

JOHN O. LEAVY
Regional Inspector General
for Audit

Attachment

EXECUTIVE SUMMARY

RESULTS IN BRIEF

We performed an audit of individuals B and C's joint venture (JV) farming operation in Bryan County, Oklahoma, to determine if payment limitation provisions were violated. We also reviewed a corporation's (solely-owned by individual A) activity based upon its association with the JV and individuals B and C. The audit was performed at the request of the Oklahoma State Farm Service Agency (FSA) Office after an end-of-year review by FSA disclosed serious eligibility questions regarding payment limitation rules.

Our review disclosed that individual A (doing business as a corporation) initiated actions to evade payment limitation provisions. The actual farming operation and related transactions of individuals B and C were controlled by individual A, who concealed his true interest in the JV's farming operation. Our review revealed that individual A, hired an attorney and a farm consultant to prepare the JV agreement, a land lease, and equipment purchase documents. While the JV entity was established on paper, our review of 1997 and 1998 records for the JV and corporation showed that the JV was not separate and distinct from individual A's corporate operation. We concluded that individual A's entity, with the assistance of individuals B and C, orchestrated the establishment of the JV entity to obtain additional program payments rather than as an entity to conduct separate farming operations. As a result, program payments totaling $450,887 issued to individuals B and C and the corporation for 1997 through 1999 are subject to refund if FSA determines these individuals adopted a scheme or device to obtain unauthorized payments.

The JV farming operation was carried out in such a manner that individuals B and C did not meet the criteria to be considered actively engaged in farming or separate persons for 1997 and 1998. Contrary to the farm operating plans they submitted, we found that individual A's corporation financed the JV by providing the capital, land, equipment, and operating expenses for 1997 and 1998. Although an equipment note and a land lease were prepared, the corporation did not require the JV to honor the written agreements. Further, records showed that the corporation not only paid the daily farm operating expenses for the JV's crop A operation in 1997 and 1998, but also directly received the proceeds from the production of crop A in 1997. The corporation, as the landowner, provided all of the major investments and assumed the risk for loss or gain on the JV's crop A operation.

Additionally, the JV did not maintain funds and accounts separate from the corporation and did not exercise separate responsibility for its interest in the crops. Further, our review disclosed that the JV did not establish any trade accounts for fertilizer, fuel, chemicals, seed, and other farm related supplies common to the operation of crop A. Other than a handwritten summary of revenue and expenses for 1997 and 1998, the JV did not maintain any records to show expenses relating to the equipment notes, land lease payments, and trade accounts for the farming operation. The JV's operating expenses were commingled with the corporation's crops A and B expenses. Since the corporation and the JV did not maintain separate accounts and they could not determine what either party owed, we concluded they were not separate and distinct operations.

We also concluded that individual A placed individuals B and C on the land as hired employees of the corporation to receive program payments that he would not have otherwise qualified for through the corporation. A summary of monetary results is shown as exhibit A.

KEY RECOMMENDATIONS

We recommend FSA determine whether individuals A, B, and C violated scheme or device, actively engaged in farming, and separate person payment limitation provisions for 1997 and 1998. We also recommend that FSA apply the most restrictive rule in their determinations and collect up to $450,887 in 1997 through 1999 program payments issued to individuals B and C and individual A's corporation as appropriate.

AGENCY RESPONSE

A written response to the draft report (see exhibit E) shows that the Oklahoma State FSA Office agreed with the recommendations and will have a joint meeting with the Bryan County FSA Committee and the Wagoner County FSA Committee in order for them to make a determination based on information provided in the audit. Based on the determination made at the joint committee meeting, FSA will notify individuals A, B, and C of the amounts of repayment required.

OIG POSITION

We are in agreement with the action taken to date, however, to reach management decisions on the recommendations, we will need a written response showing the joint committee's determination and documentation showing that any ineligible payments are recovered in the agency's accounting records.

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INTRODUCTION

BACKGROUND

A limitation on the total annual payments that a person may receive under agricultural programs has been in effect since the enactment of the Agricultural Act of 1970. Subsequent legislation, including the Food Security Act of 1985, the Omnibus Budget Reconciliation Act of 1987, and the Food, Agricultural, Conservation, and Trade (FACT) Act, modified the provisions that define a person and the rules for payment limitation and payment eligibility. Most recently the Agriculture Marketing Transition Act (AMTA) was initiated under Title I of the Federal Agriculture Improvement and Reform (FAIR) Act of 1996, Public Law 104-127, dated April 4, 1996 (the Farm Bill). The AMTA authorized production flexibility contract (PFC) payments to producers on farms with feed grain, cotton, and rice bases.

Under the Farm Bill, a $40,000 payment limitation ceiling per fiscal year (FY) applies to PFC payments, but there are provisions that exclude certain allocated funding from this limitation. The payments subject to the $40,000 limitations are termed “SL” payments, while excluded payments termed “NL” payments are subject to a $50,000 limitation over the 7-year life of a contract. Marketing loan gains and loan deficiency payments have a $75,000 limitation any one person can receive.

The Omnibus Budget Reconciliation Act of 1987 amended the Food Security Act of 1985 to define the terms "person" and "actively engaged in farming." For payment limitation purposes, a "person" is an individual or an individual participating as a member of a joint operation or similar operation, including corporations and partnerships.

For an individual or entity to be considered a separate person, the individual or entity must

- have a separate and distinct interest in the land or crop involved,
- exercise separate responsibility for this interest, and
- maintain funds or accounts separate from that of any other individual or entity for this interest.

For individuals or entities to be considered "actively engaged in farming," they must

- make significant "left-hand" contributions to the farming operation of one or a combination of (1) capital, (2) land, and/or (3) equipment;

- make significant "right-hand" contributions to the farming operation of one or a combination of active personal labor or active personal management;

- claim a share of the profits or losses from the farming operation that is commensurate with contributions to the farming operation; and

- the contributions must be at risk.

If a producer has adopted or participates in adopting a scheme or device that is designed to evade, or has the effect of evading, the rules of the payment limitation and payment eligibility provisions, the producer is ineligible to receive farm program payments subject to limitation for the crop year for which the scheme or device was adopted and for the succeeding year. Acts that are considered schemes or devices include but are not limited to

- concealing information that affects the application of payment limitation provisions,

- submitting false or erroneous information, or

- creating fictitious entities for the purpose of concealing the interest of a “person” in a farming operation.

OBJECTIVE

The audit objective was to determine whether a JV in Bryan County, Oklahoma violated payment limitation provisions.

SCOPE

The scope of our review included the 1997 and 1998 farming operations of the JV. We also made a review of a corporation’s (solely owned by individual A) program participation based upon its association with the JV and individuals B and C. We conducted fieldwork at the Bryan and Wagoner County FSA Offices from October 13, 1999, to April 10, 2000.

Prior to our review, the Oklahoma State FSA Office conducted an end-of-year review for the 1997 crop year that disclosed evidence of potential payment limitation violations by individuals A, B, and C. Because of these indicated violations, the Oklahoma State FSA Office requested the Office of Inspector General (OIG) review the JV’s financial and farming operations to determine the extent of payment limitation rule violations.

The following table summarizes the 1997 through 1999 program payments for the JV and corporation.

PRODUCER	YEAR	PROGRAM PAYMENTS
JV	1997	$ 56,494
	1998	83,771
	1999	131,603
Corporation	1997	23,791
	1998	50,226
	1999	105,002
Total Payments		**$450,887**

This audit was performed in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, the audit included such tests of program and accounting records as considered necessary to meet the audit objective.

METHODOLOGY

To accomplish the audit objective, we reviewed 1997 and 1998 program records maintained by the Oklahoma State FSA Office, Bryan County FSA Office, and Wagoner County FSA Office. We interviewed FSA officials at three FSA offices and individuals A, B, and C. As applicable, we reviewed 1997 and 1998 bank statements, canceled checks, deposit slips, Federal income tax returns, bank records, loan agreements, crop settlement sheets, equipment listings, deeds of trust, land lease agreements, expense listings, real estate notes, equipment notes, fuel records, and chemical receipts. In addition, we reviewed records made available by certified public accounting (CPA) firms, marketing agencies, and others as considered necessary to confirm transactions affecting the 1997 and 1998 farming operations included in our audit.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	PRODUCERS ADOPTED SCHEME OR DEVICE TO EVADE PAYMENT LIMITATION RULES

FINDING NO. 1

Individual A, operating as a corporation, used two employees of his corporation to establish individuals B's and C's JV. The JV was used as a "front" to cash lease part of the corporation's cropland and qualify additional individuals B and C for payment limitation purposes. Our review disclosed that the members of the JV were not actively engaged in farming and not separate persons because individual A's corporation controlled all aspects of the JV's farming operation. We, therefore, concluded that these individuals concealed the true interests in the JV farming operation to evade payment limitation provisions. This arrangement allowed individual A to receive program payments that he would not have otherwise qualified for as one person through the corporation. As a result, program payments totaling $450,887 received by the JV and corporation for 1997 through 1999 are subject to refund if FSA makes an adverse scheme or device determination.

Regulations provide that any producer who participates in adopting a scheme or device to evade payment limitation shall be ineligible to receive payments subject to payment limitation and payment eligibility provisions for the year in which the scheme or device was adopted and for the succeeding year. Acts that are considered a scheme or device include, but are not limited to

- concealing information that affects the application of the payment limitation provisions,
- submitting false or erroneous information, or
- creating fictitious entities for the purpose of concealing the interest of a person in a farming operation.[1]

[1] FSA Handbook 1-PL, (Revision 1), amendment 34, paragraph 71 E, dated February 18, 1997.

Provisions further provide that, if the county office committee (COC) or State committee determines that a producer or person adopted a scheme or device to evade, or had the purpose of evading, payment limitation rules, all payments received by a person for the year in which the scheme or device was adopted are to be refunded, and FSA is not to make payments to the person in the succeeding year.[2]

BACKGROUND

In 1996, Individual A was the owner of a corporation operating a farming operation in Wagoner County, Oklahoma. The corporation's operation consisted of four farms participating in the AMTA program on 463.3 contract acres of wheat, oats, corn, and sorghum that qualified for PFC payments totaling $8,648 in 1996. Individual A was combined with the corporation as one person for payment limitation purposes. In 1997, the corporation purchased an additional 3,667 acres in Bryan County, Oklahoma, and hired individuals B and C to manage 567 acres of this acreage for the crop B business. Individuals B and C, subsequently established a JV and cash leased the remaining 3,100 acres purchased by the corporation. The JV was approved to participate as two persons in Bryan County. The 567 acres retained for crop B were combined with the corporation's operations in Wagoner County. The corporation earned farm program payments in both Wagoner and Bryan Counties while individuals B and C received payments in Bryan County, farming as a JV.

Individual A discussed with Wagoner County FSA Office officials his intentions to purchase additional property in Bryan County. He told them the land he planned to purchase had several hundred acres of base on which the payments, when combined with his current participating farm in Wagoner County, would exceed the $40,000 payment limitation. The farm had 2,971.5 AMTA contract acres of wheat, corn, and sorghum that qualified for over $60,000 in estimated PFC payments for each of the remaining 6 years (1997 through 2002) of the contract. Individual A further stated that he was considering recording the land on the deed in his name rather than in the name of the corporation in order to receive more than the one-person PFC limit of $40,000. The Wagoner County office representative told him that since he owned 100 percent of the corporation as an individual, he would be combined with the corporation and limited to one person for payment limitation purposes. Individual A then said he was going to obtain the services of a consultant, a former employee in the Oklahoma State office, to set up the farming operation in Bryan County.

On January 14, 1997, the Bryan County FSA Office received a letter from individual A's attorney stating that part of the reason individual A purchased the farm in Bryan County was the availability of the 7-year (6 years remaining) PFC. The letter further stated that in order to qualify for all of the

[2] FSA Handbook 1-PL (Revision 1), amendment 34, paragraph 71 F, dated February 18, 1997.

available PFC payments, it would be necessary for the payments to be made to two or more entities. The letter requested copies of the applicable regulations governing the AMTA program, including information on the kinds of entities that were qualified to receive PFC payments.

The Bryan County executive director's (CED) January 27, 1997, written response addressed the maximum payments each person could earn along with the eligibility requirements for earning such payments. It specifically stated that a farm operator would not qualify unless the operator provided a significant contribution of land, equipment, or capital, as well as active personal labor or management. It also pointed out that an end-of-year review team usually reviewed new entities collecting payments in excess of $40,000 and that a review for 1997 could be expected if that was the case. A copy of the Federal Register Part 1497, "Payment Limitation," and a listing of the maximum PFC payments the farm could earn for the remaining 6 years of the PFC were included with the written response. The Bryan CED told us that an employee from Wagoner County had informed him that individual A had contacted the employee and wanted to know how to get around the $40,000 payment limitation.

In May 1997, a farm consultant, hired by individual A, contacted the Bryan CED and scheduled a meeting, which was also attended by individuals A, B, and C. At the meeting, individual A stated that individuals B and C had leased approximately 3,100 acres of the newly acquired farm as of March 27, 1997, to grow crop A. The corporation would operate the remaining 567 acres for crop B. The consultant explained to the CED how individual A planned to divide the farm between the corporation and JV. He sought assurance from the CED that the farm reconstitution could be timely completed for participation in the 1997 AMTA program. As a result of this meeting and prior conversations with Wagoner County officials, the CED and COC were concerned that individual A was trying to avoid payment limitation provisions.

A reconstitution was approved splitting the purchased farm into two separate farms. One farm, containing 567 acres, retained 565.1 of the PFC acres with over $10,000 in estimated PFC payments per year. The other farm contained the remaining 3,100 acres with 2,406.4 PFC acres and estimated PFC payments of over $50,000 per year.

On May 12, 1997, individuals B and C completed Form CCC-502B, Farm Operating Plan for Payment Eligibility Review for a JV or General Partnership, to participate in the 1997 AMTA program in Bryan County as a fifty-fifty JV. On July 8, 1997, the Bryan COC approved the JV to participate as two persons for payment limitation purposes. In addition to PFC payments, the JV also received marketing loss assistance (MLA) and loan deficiency payments (LDP) for both 1998 and 1999.

On June 20, 1996, individual A completed Form CCC-502C, Farm Operating Plan for Payment Eligibility Review for Corporations, Limited Partnerships, or Other Similar Entities, in Wagoner County. On July 11, 1996, the Wagoner COC approved the corporation to participate as one person for payment limitation purposes. In 1997, the Wagoner County operation was combined with the additional land purchased in Bryan County that was not cash leased to the JV. Wagoner County served as the FSA control county for the corporation, but the corporation received payments in both Bryan and Wagoner Counties for a PFC in 1997; PFC and MLA in 1998; and a PFC, MLA, and LDP in 1999. The 1997, 1998, and 1999 program payments for the JV and corporation in Bryan County, along with the corporation's payments in Wagoner County, totaled $450,887, as shown in exhibit B.

On June 2, 1998, the Bryan County FSA Office notified the JV that they were selected for a 1997 payment limitation and payment eligibility end-of–year review. Documents and information were requested to verify whether the farming operation was carried out in 1997 as represented on the form CCC-502B on which the initial payment limitation and payment eligibility determinations were based. The review team identified several discrepancies between the information reported (certified) on form CCC-502B and the way the operation was actually being conducted, but they could not draw firm conclusions because the producers did not provide adequate information. The end-of-year review team believed that the JV producers had not done what was necessary, by regulation, to qualify for payments which were issued; however, based on the records to which FSA had access and statements made by individuals A, B, and C, a determination could not be made.

On June 1, 1999, the Bryan County COC met and reviewed the results of the 1997 end-of-year review on the JV. Based on this information, the COC had strong indications that individual A, doing business as the corporation, and individuals B and C had participated in a scheme to evade the payment limitations. There were indications that individuals B and C were simply listed as operators in order to receive PFC payments in excess of the $40,000 payment limitation. However, since the review team was unable to obtain the documentation needed to make a clear and decisive recommendation to the COC, the Oklahoma State FSA Office requested further assistance from OIG on June 14, 1999.

OIG REVIEW

Based on the events that led to the formation of the JV and our review of how the farming operation was carried out, we concluded that individual A established the JV on paper to circumvent payment limitation rules. He talked with FSA personnel, obtained the AMTA and payment limitation regulations, and used a consultant and lawyer to (1) divide the PFC payment acres on a newly acquired farm between his corporation and the JV, and (2) create the JV to qualify two additional persons. While this was accomplished on paper, the conduct of the actual farm operators did not support a JV that was separate and distinct from individual A's corporation.

The JV created documents and took actions, under the direction of individual A, to make the operation appear separate and distinct to FSA. The JV's farm operating plan was completed to show that individuals B and C were contributing the necessary farming inputs (capital, land, and equipment) to qualify them as two persons, actively engaged in farming, and separate and distinct from any other individual or entity. These contributions of farming inputs were further defined in a written JV agreement between individuals B and C, prepared by a representative of individual A. To further establish the farming operation, a checking account was opened, a written land lease agreement with individual A's corporation was signed, and a bill of sale, promissory note, and security agreement were executed for the JV's purchase of equipment from the corporation.

Although the above documents established the JV and served as the basis for FSA to approve the JV for a two-person payment limitation (individuals B and C), we determined that the actual farming operation was not conducted in the manner prescribed in the noted documents. Individuals B and C could not obtain a bank loan for operating funds and could not establish trade accounts; therefore, individual A's corporation financed the JV throughout the year. The JV's bank account and the members' tax returns did not reflect the total income or expenses for the 1997 and 1998 crop A operations. The only income the JV showed for 1997 was PFC payments that were immediately paid out to the corporation for a partial land lease payment (the only expense recorded for the year). The JV had not reimbursed the corporation for daily farming expenses and had not made the required payments for the cash-leased land or purchased equipment. Individuals B and C also did not use any part of their salaries from the corporation to pay for the expenses of the crop A operation. The security agreement for the equipment stated that nonpayment of at least the interest due each year would cause the JV to default on the agreement, and the corporation could take possession of the equipment.

We concluded that individual A's corporation actually operated the JV's farming operations and individuals B and C were merely paid employees of the corporation. The corporation owned the land and could reclaim the equipment since the JV had defaulted on the interest payments. All PFC

payments and crop proceeds were funneled back to the corporation in partial land or equipment payments and/or reimbursements of prior daily expenses paid by the corporation. The partial payments on land and equipment usually equated to the amount remaining in the JV's checking account. The corporation paid the daily operating expenses throughout the year and was, therefore, at risk for the operation should the crop fail.

The corporation did not require the JV to make land and equipment payments, which indicated that the corporation was not concerned about delinquent land and equipment payments. The corporation had neither an accounts receivable nor notes receivable established for debts owed by the JV. In addition, the corporation appeared as the crop A producer to outside parties. All the expenses associated with the JV's crop A operation were charged to the corporation's trade accounts. Therefore, we could not verify the actual expenses for the JV's crop A operation to determine if the amounts the JV were reimbursing to the corporation were realistic or just a means to funnel all revenue to the corporation.

The 1997 crop A was sold and deposited in the corporation's name by individual A. In a letter dated August 28, 1998, to the Bryan CED, individual B stated that he had given the 1997 crop A to individual A in lieu of the rent, note payment, equipment, and taxes the JV owed to the corporation. In a November 30, 1999, interview, individual A said the 1997 crop A was in the corporation's name because the corporation's trucks hauled crop A to the grain elevator. He added that he did not sell crop A and/or did not receive proceeds from the sale of the crop. In a January 12, 2000, interview, individual B recanted the statements he made in the August 28, 1998, letter and said he gave the crop to individual A with the understanding that individual A could play the market with it or do what ever he wanted to do with the crop. Individual B further stated that individual A did not tell him how much he received from the sale of crop A or how much would be applied to the debt that he owed the corporation. Our review of the elevator records showed that the crop was delivered in the name of the corporation, the contract to sell the beans was signed by individual A for the corporation, and two checks totaling $279,620 were issued to the corporation.

None of these proceeds appeared in the JV's banking account, and the JV was not credited for any expenses owed on the corporation's books. The only deposit for the JV in 1997 was $56,494 in PFC payments, which were immediately paid to the corporation as a partial land lease payment. Aside from the equipment and land payments due in 1997, the JV owed the corporation $63,304 in operating expenses. Therefore, the corporation had a net gain of $272,810 (279,620 + 56,494 – 63,304) from the JV's crop A operation in 1997.

In 1998, the corporation received $163,200 in checks from the JV (including about $81,800 in 1998 crop A proceeds) against $105,185 expenses (excluding the equipment and land payments due) for a net gain of $58,015.

We excluded the equipment and land payments because the JV was not honoring the total obligations for these expenditures. Thus, the proceeds received from the JV more than covered the daily operating expenses incurred for the crop. The corporation owned the land, and the JV had defaulted on the purported equipment purchase by not at least paying the interest on the equipment note. According to the equipment note agreement, individual A could reclaim the equipment if the JV did not at least make interest payments. Further evidence that individuals B and C did not purchase the equipment was the fact that they did not claim depreciation for the equipment on their 1997 tax returns. Depreciation was included on their 1998 tax return after we questioned them about the missing depreciation on their 1997 tax return. (See General Comments section.)

We concluded, based on the above, that individual A was merely using hired employees of the corporation to operate his land with his equipment and getting all proceeds (crop and FSA payments) funneled back to his corporation as farm operating expenses that could not be verified because all expenses for the corporation and JV were commingled. Individuals B and C were not at risk for the JV's losses or unpaid operating expenses. Instead, they were paid for their work by the corporation and did not use any of their salaries to satisfy JV obligations.

As a result, the corporation actually received net benefits for 1997 and 1998 because crop proceeds and program payments funneled back to the corporation exceeded the daily operational expenses for the JV. The JV, established as a payment entity for the corporation, had net losses; therefore, the only benefit individuals B and C realized was the salaries they received from the corporation crop B's operation. See exhibit C for a summary of 1997 and 1998 revenue and expenses for the JV.

JV MEMBERS NOT ACTIVELY ENGAGED IN FARMING

In order for a person to be eligible to receive payments under AMTA, the person must be actively engaged in farming. Generally, members of a JV can become "actively engaged in farming" by meeting all of the requirements in the following table.

Item	Requirement
1	Contributions to the farming operation of **both** of the following are made. • The member or the joint operation makes a significant contribution of capital, equipment, or land, or a combination thereof (left-hand contribution), and • the member makes a significant contribution of active personal labor or active personal management, or a combination thereof (right-hand contribution).
2	The member must provide satisfactory evidence that his or her contributions of land, labor, management, equipment, or capital to the joint operation are commensurate with the member's claimed share of the profits or losses of the joint operation.
3	The member's contributions to the farming operation are at risk.[3]

Neither the JV nor individuals B and C made significant contributions of capital, land, or equipment in 1997 and 1998 to qualify as actively engaged in farming. In addition, the members could not be considered at risk for the contributions they did not make. The members' contributions, as reported to FSA, did not qualify because we found that individual A's corporation was responsible for them, thereby making the corporation at risk for the JV's crop A operation. Since the corporation owned the farm the JV cash leased, the corporation was considered to have an interest in the operation resulting in restrictive payment limitation rules applicable to the loans, land leases, and equipment purchases between the JV and corporation. The corporation financed the JV's farming operation both years by paying the daily operating expenses and not requiring payments on land leases and purchases of equipment. The JV purchased the equipment through a promissory note to the corporation, but the JV did not make cash-lease land payments to the corporation within a reasonable and customary time for the area as set by the COC. All of these scenarios are violations of the payment limitation rules for someone with an interest in the operation. See subheadings for capital, land, equipment, and at risk below for details.

Form CCC-502B completed and certified as correct by individuals B and C for the JV included the following contributions.

PRODUCER	PERCENT OF CAPITAL	PERCENT OF EQUIPMENT	PERCENT OF LAND CONTRIBUTION	PERCENT OF ACTIVE PERSONAL LABOR	PERCENT OF ACTIVE PERSONAL MANAGEMENT
Individual B	50	50	50	50	50
Individual C	50	50	50	40	50

In addition, form CCC-502B stated that neither member was paid a salary or bonus, 10 percent of the labor was to be hired, and the equipment was being purchased from the corporation landowner from whom the JV was cash

[3] FSA Handbook 1-PL (Revision 1), amendment 30, paragraph 294 A, dated June 27, 1995.

leasing the land. The person status for payment limitation purposes was completed by both individuals B and C requesting that each member of the joint operation be considered a person actively engaged in farming separate and distinct from any other individual or entity.

Regulations state that a landowner has an interest in the farming operation containing the land owned, whether or not the landowner has an interest in the production or proceeds from the production. Therefore, the corporation, as landowner, is considered to have an interest in the farming operation of the JV.[4]

JV Agreement

A representative of individual A drew up a written JV agreement, dated March 27, 1997, which further defined duties required of individuals B and C. The agreement stated that the members should plant as much of the farm as feasible in crop A and should thereafter grow, maintain, harvest, and sell the crop; the members should contribute all farm equipment purchased from the corporation for $308,000 under the provisions of a separate bill of sale, promissory note, and security agreement with the same date (March 27, 1997); individual B would devote his full-time and best efforts to cultivating, planting, fertilizing, irrigating, weeding, growing, maintaining, and harvesting the farm's crop; and individual C would be responsible for maintaining the books and records.

Capital

The capital used as a significant contribution by a farming operation may be borrowed. However, regulations require that borrowed capital must not have been acquired as a result of a loan made to, guaranteed by, or secured by any individual, entity, or joint operation that has an interest in the farming operation.[5] Additional restrictions on capital require that it must be contributed directly to the farming operation from a fund or account separate and distinct from that of any other individual or entity with an interest in the farming operation.[6]

Although form CCC-502B stated that individuals B and C would each contribute 50 percent of the capital to the JV's farming operation, we were unable to substantiate a significant capital contribution by either individual during 1997 or 1998. Furthermore, the capital contributed to the operation was not from an account that was separate and distinct from the corporation, an entity with an interest in the operation. During 1997 and 1998, the JV did not obtain an operating loan, had minimal activity in their checking account, and individuals B and C did not have normal farming expenses related to the JV on their Federal tax returns. Additionally, the JV only paid 36 percent

[4] FSA Handbook 1-PL (Revision 1), amendment 12, paragraph 91 A, dated July 29, 1992.
[5] FSA Handbook 1-PL (Revision 1), amendment 29, paragraph 151 D, dated March 14, 1995.
[6] FSA Handbook 1-PL (Revision 1), amendment 1, paragraph 151 B, dated August 14, 1991.

(56,494/155,000) of the land lease payment for 1997 and did not pay any cash-lease expense for 1998. The JV also did not honor the terms of the equipment lease with the corporation by at least paying the interest for 1997. Therefore, we concluded that individuals B and C, farming as a JV, did not have a significant capital contribution during 1997 and 1998.

The corporation provided the capital for conducting the daily operations of the JV farming operation. Individuals B and C did not obtain an operating loan or establish trade accounts for the daily farming operations of the JV. Individual B stated that he was unable to obtain a bank loan in 1997 or 1998 because he was not able to repay a loan from his previous farming operation in Canadian County, Oklahoma. He also stated that he did not establish trade accounts in the name of the JV for purchasing seed, fertilizer, chemicals, fuel, equipment maintenance, equipment rental, or any other farming supplies that may have been needed to conduct the operation. There were only two checks made to payees other than the corporation during 1997 and 1998, and the payments were made on the trade accounts for the corporation. Individual B stated that he had an agreement with the corporation to charge farming supplies for the operation on the corporation's accounts with vendors and that the JV would later reimburse the corporation when the JV could afford it.

In addition to not having an operating loan or trade accounts, there were absences of normal farming proceeds and expenditures in the JV's checking account for 1997 and 1998. The only deposits in 1997 were PFC payments of $28,247 to individual B and $28,247 to individual C deposited on September 23, 1997, and September 24, 1997, respectively, totaling $56,494. The only expense was a land rental payment of $56,494 on September 24, 1997, which was the exact amount received from FSA payments. After these transactions and a service charge, the account did not have any additional transactions and held a balance of $12.18 until September 1998. Therefore, there were no operating loan funds or crop proceeds deposited, and no farming expenses, other than land rent, paid out of this account during 1997.

During 1998, the checking account maintained the $12.18 balance until September 30, 1998, when PFC payments of $26,709 each to individuals B and C were deposited. The MLA payments of $13,280 each to individuals B and C were deposited on November 10, 1999, and November 12, 1999, respectively, while 1998 crop A proceeds of $81,803.84 were deposited on December 18, 1998. The remaining deposit on December 15, 1998, consisted of rebates of $1,911.81 ($2,611.81 – $700.00 cash received) from two chemical companies for purchases on the corporation's trade account .

The first expenditure occurred in the account on October 1, 1998, after the first deposit of the PFC payments, when the JV reimbursed the corporation $53,318 for fuel, seed, and chemicals. The next expense was incurred on

December 16, 1998, when two chemical companies were paid a total of $51,236.64 for chemicals charged to the corporation's trade account. The last payment from the account was on December 30, 1998, when the JV made an equipment payment to the corporation. The $58,645.19 payment was the result of the remaining balance in the checking account ($59,145.19), less a minimum balance of $500. In total, there were $163,694 in deposits and $163,206 in payments during 1998, with 69 percent of the payments made to the corporation while the remaining 31 percent of the payments were made on the corporation's trade accounts. Furthermore, the first activity in the bank account was not until September 30, 1998, even though the expenses related to crop A usually started occurring when the crop was planted in June.

An analysis of the JV's checking account for 1997 and 1998 clearly indicated that individuals B and C did not provide the capital for the JV farming operation. In addition, a review of individuals B's and C's personal bank account for 1997 and 1998 confirmed that no farming expenses for the JV were paid out of personal funds. Therefore, we concluded that the corporation provided the capital and the JV reimbursed the corporation as it received FSA program payments and crop proceeds.

The bank activity for 1997 was in agreement with the 1997 Federal tax return prepared on April 13, 1998, which stated that the only revenue was from one FSA payment received in Canadian County by individual B and two FSA payments received by individuals B and C for the JV in Bryan County. The only expense related to the JV was a land lease payment to the corporation. The remaining expenses were related to individual B's farming operations in Canadian County.

The JV bank account activity for 1998 supports the income and expenses listed on the 1998 Federal tax return except for two items. In one case, a check was written for equipment purchase and was shown as an interest and rental expense on the tax return. Another check written to the corporation for seed and fertilizer did not appear as an expense on the 1998 Federal tax return. We concluded that there were no additional 1998 expenses paid by the JV other than those paid out of the checking account. It should be noted that the 1998 tax return was prepared on February 10, 2000, after our last interview with individuals B and C on January 12, 2000.

Absence of Documentation To Substantiate JV Farming Operations

We used the activity in the JV checking account, original 1997 and 1998 tax returns, and the listing of revenue and expenses provided by individuals B and C to review the JV farming operation. See the General Comments section of this report for a discussion of the 1997 and 1998 tax returns. On October 19, 1999, we initially requested the tax returns, bank account records, crop sale documents, and receipts for farming expenses incurred by the JV. We received the 1997 bank statements along with the supporting

canceled checks and deposit slips for the JV on November 3, 1999. We received these same documents for 1998 on December 2, 1999. A review of the bank account information indicated that virtually all the checks were written directly to the corporation. We reiterated our request for copies of receipts, paid invoices, and any other documents related to farming expenses incurred by the JV that may substantiate payments made to the corporation. However, we were only provided a handwritten sheet of revenue and expenses incurred during 1997 and 1998 and were told by individuals B and C that no other documentation was available. Previously, individual A had stated that the corporation did not have a note or accounts receivable established for the JV and did not have any documents to show how much the JV owed his corporation, as it was individuals B's and C's responsibilities to keep track of the amounts they owed.

Since the corporation had a large crop B business and used the same account to pay expenses of both crop B and the farming business, we could not identify and reconcile the paid invoices for all expenses relating to the JV. Therefore, we used the revenue and expense shown on the handwritten listing and the JV's checking account, for the basis for conclusion as to whether the JV operation was a separate entity for payment limitation purposes.

In summary, individuals B and C did not make significant contributions of capital and, therefore, did not follow their forms CCC-502B for 1997 and 1998 by contributing 50 percent of the capital for the JV's farming operation. The corporation provided the necessary capital inputs for the JV's farming operation during 1997 and 1998 through the use of its trade accounts for operating expenses. Therefore, we concluded that the capital contributed to the JV was borrowed from the corporation, an entity with an interest in the operation.

Equipment

Regulations state that if the farming operation is conducted by a joint operation in which the equipment is contributed by the members, then the equipment must not have been acquired as a result of a loan made to, guaranteed by, or secured by any individual, entity, or joint operation that has an interest in the farming operation, except members of the joint operation to which the loan is made.[7]

Form CCC-502B for the JV stated that individuals B and C would each contribute 50 percent of the equipment to the farming operation and that the equipment was acquired as the result of a loan from the corporation, an entity with an interest in the operation. An equipment note, bill of sale, and financing statement substantiated the purchase of equipment from the corporation, as stated on forms CCC-502B.

[7] FSA Handbook 1-PL (Revision 1), amendment 29, paragraph 152 C, dated March 14, 1995.

Individuals B and C acquired their equipment as the result of a direct loan from the corporation. The "bill of sale" from the corporation to the individuals, doing business as the JV, was for two John Deere tractors, a Great Plains planter, a field cultivator, a Krause disk, and a land leveler. The equipment note related to the bill of sale was secured by a security interest, covering the farm equipment, all crops produced from the farm, all of maker's other tangible personal property used in the operation of the farm, all similar acquired property, and all proceeds and replacements of such assets.

Principal and interest on the equipment note were payable in one lump sum due 10 days after completion of the 1997 harvest of the principal crop from the real property in Bryan County, Oklahoma, and in Fannin County, Texas, containing approximately 3,100 acres, leased from the corporation to the JV.

Individual B stated that he did not own any additional farm equipment other than what was purchased from the corporation. This was substantiated by revised 1997 and 1998 tax returns (see the General Comments section of this report), which did not include depreciation for any other farm equipment. Therefore, individuals B and C only contributed the equipment purchased from the corporation to the JV. Since the equipment was purchased from the corporation, an entity with an interest in the operation, it does not count as a significant contribution by the JV.

Land

Regulations state that, if land is leased from another individual or entity with an interest in any crop or crop proceeds in the farming operation, provisions require the producer must prove to the COC that the land was leased at a fair market value and that payment was made within a time determined by COC to be reasonable and customary for the area.[8] Also, when any capital is borrowed by an individual, entity, or joint operation from any other individual, entity, or joint operation with an interest in the farming operation, the cash-leased land will not be considered as a significant contribution unless the individual, entity, or joint operation can prove to the COC that sufficient capital was available from another source to pay the cash lease.[9]

Individuals B and C, farming as members of the JV, entered into a cash lease with the corporation for 3,100 acres of cropland in Bryan, Oklahoma, and Fannin Counties, Texas, on March 27, 1997. This was in agreement with form CCC-502B for the JV, which stated that individuals B and C would each contribute 50 percent of the land to the farming operation and that the land would be cash leased from the corporation. The primary term of the lease began March 27, 1997, and ended without notice to tenants 30 days after completion of harvest of the principal 1997 crop. The note could have

[8] FSA Handbook 1-PL (Revision 1), amendment 22, paragraph 153 B, dated March 14, 1994.
[9] FSA Handbook 1-PL (Revision 1), amendment 1, paragraph 153 D, dated August 14, 1991.

been extended annually from the original termination date to a new termination date 30 days after completion of harvest of the farm's principal crop for the then current term, for up to four renewal terms. Individuals B and C stated that the written lease agreement applied to both 1997 and 1998. Therefore, the land lease agreement was extended to the first renewal term of 30 days after completion of harvest of the farm's 1998 crop A.

The land was cash leased for the primary term at a rate of $50 per acre for a total lease amount of $155,000 (3,100 acres X $50). The JV was required to pay one-half of the rent for each lease term, including the primary term and each effective renewal term, on April 30 of that term, and to pay the balance in full within 10 days of harvest of the principal crop for that term. Crop A was the main crop grown on the 3,100 leased acres by the JV during 1997 and 1998.

However, the JV only paid $56,494 (36 percent) of the total lease payment for 1997 and did not pay any of the lease expense for 1998. Our review of the JV checking account for 1997 and 1998 and discussions with individuals B and C confirmed that a $56,494 land lease payment was made on September 24, 1997. No other land lease payments were made during 1997 or 1998. Therefore, the JV still owes the corporation $253,506 (($155,000 X 2 = $310,000) – $56,494 = $253,506) for the cash lease of crop A acres for 1997 and 1998. A review of the 1997 Federal tax return for individuals B and C confirmed that there was only one land lease payment during 1997.

This analysis of the JV checking account indicated that the land lease payments were not made in a reasonable manner. The CED in Bryan County stated that the COC has always used December 31 of each year as the date land and equipment lease payments must be made for the payments to be considered reasonable and customary for the area. Since the 1997 and 1998 cash-lease payments to the corporation were not made by December 31 of each respective year, they were not considered reasonable and customary for the area, and the land could not count as a significant contribution by JV for either year. In addition, since individuals B and C did not provide capital and were unable to obtain operating funds through a loan or by establishing trade accounts, it is apparent that significant capital was not available from another source to pay the cash lease. As a result of the JV not making the land lease payments in a reasonable manner and the inability of the JV to obtain operating funds from a source other than the landowner, the land was ineligible for a significant contribution by the JV.

JV Was Not At Risk

Regulations state that, for a producer's contribution to be considered at risk, there must be a possibility that the producer could suffer loss. In addition, if

the producer is a joint operation, the members' contributions to the farming operation must be at risk.[10]

As members of the JV, individuals B and C were not at risk because they did not provide operating capital, equipment, or land to the JV during 1997 or 1998. Instead, the corporation provided these capital inputs by allowing the JV to use its trade accounts, land, and equipment without making the required payments. The JV only made payments to the corporation for these capital inputs as it received funds from farm program payments and crop sale proceeds. Therefore, the corporation, as an unsecured creditor of operating funds and holder of the unpaid equipment note and land lease, assumed the risk of loss for the JV.

As previously stated, individuals B and C did not provide initial capital by contributing personal funds, obtaining an operating loan, or establishing trade accounts. Individual B stated that he did not contribute personal funds and was unable to obtain an operating loan for the farming operation. Individual B further stated that he had an agreement with the corporation to charge farming supplies for the operation on the corporation's accounts with vendors and to reimburse the corporation when the JV received operating funds. This statement was in agreement with the activity in the JV's checking account that disclosed the first payment for operating expenses during 1997 was not made until FSA program payments were deposited in September. A $56,494 rent payment to the corporation was made immediately after this same amount in PFC payments was deposited. No other deposits were made during 1997, and the account balance remained $12.18 until PFC payments were received and deposited on September 30, 1998. Therefore, the JV paid no daily operating expenses (fertilizer, seed, chemicals, etc.) associated with the 1997 and 1998 crop A until October 1998.

From the date of the first deposit in 1998, September 30, through the end of the year, a total of $163,694 was deposited into the account. This total consisted of $79,978 in FSA program payments, $81,803.84 in crop A proceeds, and $1,911.81 in chemical rebates. Payments totaling $163,206 were made from these deposits, which left a $500 balance in the account on December 31, 1998. This analysis clearly shows that operating expenses incurred by the farming operation related to seed, fertilizer, chemicals, fuel, equipment maintenance, equipment rental, or any other farming supplies that may have been needed were charged to or paid by the corporation. The JV then reimbursed the corporation when it received funds. However, based on a schedule of revenue and expenses noted during our review of capital and statements made by individuals B and C, the JV was unable to reimburse the corporation for all the operating expenses incurred during 1997 and 1998. In addition, no personal funds were deposited into the JV account, as verified by individuals B and C.

[10] FSA Handbook 1-PL (Revision 1), amendment 1, paragraph 159 A, B, and C, dated August 14, 1991.

The corporation also provided capital inputs of land and equipment to the JV without receiving the payments in a reasonable time, as required in the land lease, equipment note, and program regulations. The JV executed a cash-lease agreement for 3,100 acres at $50 per acre for a total annual lease payment of $155,000. However, the JV only paid $56,494 (36 percent) of the total lease payment during 1997 and did not make a payment during 1998, leaving a remaining balance of $253,506 still owed to the corporation for 1997 and 1998.

The equipment note between individuals B and C, doing business as the JV, and the corporation required that the principal and interest be paid in one lump sum due 10 days after the 1997 harvest of the principal crop. The note stated that principal payment could have been extended annually, if the interest was paid annually, when due. As with the land lease, the JV did not honor the terms of the equipment note and at least pay the interest when it was due. In fact, an equipment payment was not made until December 30, 1998. This was after the interest due date for both 1997 and 1998 crops. The settlement sheets from 1998's crop A indicated that the crop was delivered to the grain company between September 4, 1998, and October 23, 1998.

Furthermore, the $58,645.19 payment was not based on a schedule but was the result of the remaining balance in the checking account ($59,145.19), less a minimum balance of $500. In fact, individuals B and C stated they did not know how much of the payment applied to interest and principal because there was no payment schedule, and they just paid the corporation what was left in the checking account.

Based on the $308,000 principal amount of the note and the 9-percent interest rate, the interest amount due would have been approximately the amount of the equipment payment made on December 30, 1998. A simple interest calculation would have resulted in an interest payment of $48,908, according to the following calculation. A total of 364 days in 1998 and 280 days (365 less 85 days, representing January 1 through March 26) in 1997 equaled 644 days subject to finance charges at a 9-percent annual interest rate. We multiplied the daily interest rate (.09/365) by the total number of days (644) and the principal amount financed ($308,000) to calculate the interest payment. Our calculation was in basic agreement with the 1998 tax return, which showed other interest expense of $48,910.

The land lease and equipment note were both secured by a security agreement covering the farm equipment, all crops produced from the farm, all of the JV's other tangible personal property used in the operation of the farm, all similar acquired property, and all proceeds and replacements of such assets. However, individuals B and C, farming as the JV, did not have any farm equipment other than what was included in the equipment note. Since the interest expense for the equipment during 1997 and 1998 was $48,910, the producers could only have had approximately $9,735.19

($58,645.19 – $48,910) equity in the equipment according to statements made by individuals B and C.

The JV did not deposit 1997 crop revenue into the checking account because individual B gave the 1997 crop A to the corporation. Individual B stated that he told individual A to play the market with the crop, but they did not have an agreement on the amount he would be paid or when he would receive the proceeds. Therefore, the corporation assumed the risk of loss for selling the crop on the open market.

Since individuals B and C did not have any significant capital contributions of operating funds, equipment, or land and did not pay all of their operating expenses or honor the equipment note or land lease, they were not at risk for the farming operation. Instead the corporation assumed the risk for the farming operation by providing unsecured operating funds and not requiring the JV to pay the land lease and equipment note as required per the agreements and program regulations. In fact, a note receivable or account receivable was not established between the corporation and JV to provide for repayment of these unpaid operating expenses, and individual A stated that he did not know how much the JV owed the corporation. This indicated that individual A was not concerned whether the corporation was repaid for the farming expenses and assumed the risk for the JV. The corporation additionally assumed the risk for selling the 1997 crop A on the open market.

In summary, individuals B and C, farming as the JV, did not provide a significant contribution of capital, equipment, or land to the farming operation during 1997 and 1998. As such, individuals B and C were not at risk because the corporation assumed the risk of loss for the JV. Therefore, individuals B and C did not meet the applicable program requirements and were not actively engaged in farming for 1997 or 1998.

Separate Person

Regulations provide that, for an individual or entity to be considered a separate person for payment limitation purposes, the individual or entity must

- have a separate and distinct interest in the land or crop involved,
- exercise separate responsibility for this interest, and
- maintain funds or accounts separate from that of any other individual or entity for this interest.[11]

[11] FSA Handbook 1-PL (Revision 1), amendment 23, paragraph 110 B, dated April 25, 1994.

Individuals B and C did not operate as separate persons from individual A's corporation in 1997 and 1998. The JV did not maintain funds or accounts separate from the corporation and did not exercise separate responsibility for its interest in the crops. The corporation was responsible for the daily operating expenses and, in essence, provided the land and equipment because the JV did not make the scheduled payments. As a result, individuals B and C should be combined with the corporation for payment limitation purposes.

The expenses and accounts associated with the JV became commingled with those of the corporation. The JV's daily farming expenses were charged on the corporation's vendor accounts and then paid by the corporation. The corporation only had one account for paying all of their expenses with no separate expenditure coding system to distinguish the corporation's crops A and B operations from crop A's operation of the JV. The corporation and the JV appeared to have no knowledge of what the other party owed other than the handwritten revenue and expense sheet.

To complicate the situation, in 1998 the corporation bought an additional farm in Bryan County and used it to produce crop A. Individual B, as a salaried employee of the corporation, was responsible for growing and harvesting the crop for the corporation. During this same year, the JV also planted crop B on part of the land it used for crop A in 1997. Therefore, the corporation and JV were both raising the same crops during 1998 while all the expenses for these crops were charged to the same account on the corporation's books.

Although individuals B and C provided us a list of expenses incurred by the JV, we believe that there were several more expenditures for the operation commingled with corporation A's accounts which were not included. First, there were no expenses for sprigs, fertilizer, and chemicals related to the JV's crop B operation in 1998 on the revenue and expense listing. In addition, the corporation paid $15,368 on four invoices related to the JV's 1997 crop A operation that were not accounted for in the JV's 1997 revenue and expense schedule. Individual B stated that the JV still owes the corporation for these expenses, but they were mistakenly left off the expense listing. He further stated that individual A was unaware that these additional expenses were owed to the corporation. With no separate records or accounts, the expenditures for the JV were commingled with the corporation. With the expenses for both operations charged to the same accounts and the corporation incurring over $3.5 million in 1997 expenses, it is difficult to distinguish between the corporation's and the JV's operations. This is illustrated by the fact that individuals B and C had difficulty in determining the expenses related to the JV, as noted above.

In addition to not maintaining funds and accounts separate from the corporation, individuals B and C also did not exercise separate responsibilities for their interests in the JV's 1997 and 1998 farming

operations. The following instances were noted where individuals B and C were not responsible for their interests in the farming operation.

- The corporation financed the farming operation of the JV. Individuals B and C did not obtain an operating loan or establish trade accounts as noted above. In response to our questions regarding the minimal activity in the JV's checking account, individual B stated that the JV had an agreement with individual A to charge farming supplies for the JV's farming operation on the corporation's accounts with vendors and reimburse the corporation at a later date. However, as of January 2000, individual B stated that he still owed the corporation for 1997 and 1998 farming expenses.

- Individuals B and C did not sell the 1997 crop A. Individual B stated that he gave the 1997 crop to individual A with the understanding that he could play the market with it. He further stated that they did not agree on a price for the crop, and as of January 12, 2000, he still did not know what he was going to receive for the sale of the crop. Therefore, individual B did not exercise control over the sale of the crop or management of the proceeds.

- The JV planted crop B on a portion of the 3,100 acres they cashed leased from the corporation in 1998. The corporation provided the sprigs and equipment used for planting crop B. Individual B stated that the JV did not pay the corporation rental for the equipment and also did not reimburse it for the sprigs. When the crop was ready for harvest, they would give the crop to the corporation in a manner similar to the 1997 crop A.

- Individuals B and C, farming as members of the JV, cash leased 3,100 acres from the corporation for an annual rental payment of $155,000. The JV only paid $56,494 (36 percent) of the total cash-lease payment of $155,000 for 1997 and did not pay any of the lease expense for 1998. Therefore, the JV still owes the corporation $253,506 (82 percent) of cash-lease payments for 1997 and 1998.

- The equipment note between individuals B and C required that the principal and interest be paid in one lump sum due 10 days after the 1997 harvest of the principal crop. The principal payment could have been extended annually if interest was paid annually when due. The JV did not honor the terms of the equipment note and at least make an interest payment in 1997. This caused the JV to default on the equipment note and had the effect of the corporation providing the equipment to the JV at no cost.

- The corporation provided the combine for harvesting and trucks for hauling crop A for 1997 and 1998. The JV did not pay, and there was no agreement to pay rental fees for use of the equipment. Individual B stated that when it was time for harvest a combine just showed up on the farm, and he used it.

Conclusion

Based on the manner in which the JV conducted its farming operations in 1997 and 1998 as described above, it is evident that individuals B and C, employees of the corporation, were placed on the land as operators. This allowed individual A to conceal his true interest in the farming operation, thus allowing the corporation to receive payments in excess of the payment limitation for one person.

RECOMMENDATION NO. 1

Determine whether scheme or device, actively engaged in farming, and separate person payment limitation provisions were violated by individuals A, B, and C for 1997 and 1998.

FSA Response

The FSA will have a joint meeting with the Bryan County FSA Committee, which is the control county for individuals B and C, and the Wagoner County FSA Committee which is the control county for individual A, in order for them to make a determination based on information provided in the audit.

OIG Position

We agree with the action taken to date, however, to reach a management decision for this recommendation, we will need to have a written response showing the joint committee's determination.

RECOMMENDATION NO. 2

Apply the most restrictive rule and collect up to $450,887 in 1997 through 1999 program payments issued to individuals B and C and individual A's corporation as appropriate, if adverse determinations are made for Recommendation No. 1.

FSA Response

Based on the determination made at the joint committee meeting (for Recommendation No. 1), FSA will notify individuals A, B, and C of the amount of repayment required. (See exhibit E.)

OIG Position

To reach a management decision for this recommendation, we will need documentation showing that any ineligible payments are recovered or set up as accounts receivable.

GENERAL COMMENTS

At the completion of our fieldwork, individuals B and C submitted, through their CPA, a revised 1997 Federal tax return dated February 9, 2000. This return included additional expenses and income not listed on the original tax return, dated April 13, 1998, which was obtained from the CPA on December 1, 1999. The tax return was submitted after our discussion with individuals B and C, on January 12, 2000, when individuals B and C were questioned about the financial aspects of the JV's farming operation. During this interview, they provided explanations for revenue and expenses, which did not match activities in the JV checking account. See the listing of revenue and expenses in exhibit C.

Schedule F of the original tax return combined the income and expenses for individual B's operations in Canadian County, Oklahoma, with the JV's crop A operation in Bryan County, Oklahoma. The only portion of this schedule that related to crop A's operation was revenue from agriculture program payments and a land lease expense for this same amount. This revenue and expense amount was in agreement with activity in the JV checking account for 1997. The only other activities were miscellaneous bank fees with minor expense items under $300 and a minimum deposit to open the checking account. In addition, there were no farming expenses paid out of individuals' B and C personal account for the JV that should have appeared on the tax return. Since the CPA stated that the tax return was prepared on a cash basis, we concluded that the original tax return dated April 13, 1998, was an accurate reflection of the activity in the JV's checking account.

Individual B's operations and the JV's crop a operation were on separate schedules F on the revised 1997 tax return. The schedule F for crop A's operation included additional income and expenses not included on the original return. The additional income was for sales of products raised. However, the JV did not sell a crop in 1997. Corporation A sold the 1997 crop A produced by the JV and received $279,620 in crop proceeds on March 17, 1998. Individual B stated that he gave the crop to individual A for him to sell and had not received any of the 1997 crop proceeds. The JV raised no other crop during 1997. Since the crop was not sold until 1998, the proceeds could not be included on the 1997 tax return, prepared on the cash basis.

The additional chemical, freight and trucking, and lease expenses on the tax return agreed with the revenue and expense listing provided by individuals B and C but were never paid. The car and truck expenses added to the revised tax return, which were not included on the expense listing, also were not paid. Since these expenses were not paid in 1997, they should not have been included on the revised tax return prepared on a cash basis.

The depreciation expense on the tax return was not a cash outlay and would not have been included in the checking account. However, the additional depreciation expense, which was related to the depreciation of the farm equipment purchased from the corporation, was not included on the revised return until we questioned individuals B and C about its absence.

The 1998 tax return, dated February 10, 2000, also did not agree with the activity in the JV's checking account. The account had additional expenditures that were not included on the tax return. There was a payment for seed and fertilizer to the corporation, not included on the tax return while a repairs and maintenance expense on the tax return was never paid from the JV's checking account. Another discrepancy was a payment to the corporation for equipment on December 30, 1998, which was classified as other interest expense and other rental expense on the tax return. This return was also prepared after our last interviews with individuals B and C.

We do not know if the revised 1997 return was filed with the Internal Revenue Service. Due to the differences noted above, we believe the revised 1997 return was prepared to collaborate a schedule of revenue and expenses provided and statements made by individuals B and C during our last interviews on January 12, 2000. We requested the CPA to provide us the supporting schedules used to prepare the revised 1997 tax return. Initially, he stated that he would provide the requested information. However, before the information was transmitted, individual C contacted us and stated that we could no longer contact the CPA, and we had all the information from the JV's operations.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

Finding Number	Recommendation Number	Description	Amount	Category
1	2	Scheme or Device Was Adopted to Evade Payment Limitation	$450,887 A/	Questioned Costs, Recovery Recommended
Total			**$450,887**	

A/ See exhibit B for details of overpayment amounts for scheme or device and not actively engaged in farming.

EXHIBIT B – SUMMARY OF 1997, 1998, AND 1999 FARM PROGRAM PAYMENTS ISSUED TO JV MEMBERS AND THE CORPORATION

Producer	Year	SL PFC Payments	NL PFC Payments	MLA Payments	LDP Payments	Total
JV Members	1997	$ 50,534.00	$5,960.00	$ 0.00	$ 0.00	B/ $ 56,494.00
JV Members	1998	53,418.00	0.00	26,560.00	3,793.21	B/ 83,771.21
JV Members	1999	51,388.00	0.00	51,388.00	28,827.35	131,603.35
Total for JV Members		$155,340.00	$5,960.00	$ 77,948.00	$32,620.56	$271,868.56
Corporation	1997	$ 22,302.00	$1,489.00	$ 0.00	$ 0.00	$ 23,791.00
Corporation	1998	31,581.00	0.00	18,645.00	0.00	50,226.00
Corporation	1999	37,584.00	0.00	40,000.00	27,417.93	105,001.93
Total for Corporation		$ 91,467.00	$1,489.00	$ 58,645.00	$27,417.93	$179,018.93
Total for JV Members and Corporation		**$246,807.00**	**$7,449.00**	**$136,593.00**	**$60,038.49**	**A/ $450,887.49**

A/ If a scheme or device is determined, the 1997, 1998, and 1999 payments to the JV and corporation should be collected.

B/ The payments to JV for 1997 and 1998 of $140,265.21 ($56,494 + $83,771.21) should be collected if a not actively engaged in farming determination is rendered. This amount is included in the $450,887 if scheme or device is determined.

EXHIBIT C – INFORMATION SHOWN ON HANDWRITTEN LISTING OF JV REVENUE AND EXPENSES

Description/Payee	1997 Expense	1997 Revenue	1998 Expense	1998 Revenue
Rent	$155,000.00		$155,000.00	
Equipment Note	308,000.00		A/	
Preplant Herbicide	57,200.00		0.00	
Fuel	6,103.98		11,098.00	
Crop A	0.00		17,708.88	
Crop A	0.00		34,157.76	
Seed and Chemical	0.00		42,220.00	
FSA PFC Payment		$28,247.00		$ 26,709.00
FSA PFC Payment		28,247.00		26,709.00
FSA MLA Payment		0.00		13,280.00
FSA MLA Payment		0.00		13,280.00
Seed Rebates		0.00		2,611.81
1998 Crop A Proceeds		0.00		81,803.84
Total	**$526,303.98**	**$56,494.00**	**$260,184.64**	**$164,393.65**

A/ The $308,000 was also listed for 1998 on the schedule provided by individuals B and C, since no payments were made on the equipment note in 1997. It is not included for 1998, as it would be a duplicate listing of the same expense.

EXHIBIT D – SUMMARY OF COMBINED EXCESS PROGRAM BENEFITS RECEIVED BY THE CORPORATION

1997					
Description	**SL PFC Payments**	**A/ NL PFC Payments**	**MLA Payments**	**LDP Payments**	**Total Paid In Excess of Payment Limit**
Program Payment Limitation for One "Person"	$40,000.00	$50,000.00	N/A	N/A	
Payments to Corporation	22,302.00	1,489.00			
Amount Remaining Under Pay Limit - Corporation	17,698.00	48,511.00			
Payments Received by JV	50,534.00	5,960.00			
Less: Amount Remaining Under Pay Limit for Corporation	17,698.00	48,511.00			
Amount Paid Over Corporation Payment Limitation for One "Person"	$32,836.00	$ 0.00			B) $32,836.00

1998					
Description	**SL PFC Payments**	**A) NL PFC Payments**	**MLA Payments**	**LDP Payments**	**Total Paid In Excess of Payment Limit**
Program Payment Limitation for One "Person"	$40,000.00	$50,000.00	$19,888.00	$75,000.00	
Payments to Corporation	31,581.00	0.00	18,645.00	0.00	
Amount Remaining Under Pay Limit - Corporation	8,419.00	48,511.00	1,243.00	75,000.00	
Payments Received by JV	53,418.00	0.00	26,560.00	3,793.21	
Less: Amount Remaining Under Pay Limit for Corporation	8,419.00	48,511.00	1,243.00	75,000.00	
Amount Paid Over Corporation Payment Limitation for One "Person"	$44,999.00	$ 0.00	$25,317.00	$ 0.00	B/ $70,316.00

A/ The $50,000 payment limitation for NL PFC payments applied to the entire 7-year contract.
B/ The $103,152 ($32,836 + $70,316) paid in excess of the corporation's payment limitations for 1997 and 1998 should be collected if it is determined that the corporation and JV should be combined into one person for payment limitation purposes This amount is included in the $450,887 if scheme or device is determined (see exhibit A).

N/A - The MLA and LDP programs were not in effect during the 1997 crop year.

EXHIBIT E – FSA RESPONSE TO THE DRAFT REPORT

UNITED STATES DEPARTMENT OF AGRICULTURE

FARM SERVICE AGENCY

Oklahoma State FSA Office
100 USDA, Suite 102
Stillwater, OK 74074-2653

June 14, 2000

TO: USDA-OIG – Southwest Region - Audit
ATTN: 03099-26-Te

FROM: Terry L. Peach
State Executive Director

SUBJECT: Payment Limitation Review in Bryan County, Oklahoma

We have reviewed the subject audit and agree with the recommendations. We plan to take the following action(s) concerning the recommendations:

Recommendation No. 1 – Determine whether scheme or device, actively engaged in farming and separate person payment limitation provisions were violated by individuals A, B, and C for 1997 and 1998.

FSA will have a joint meeting with the Bryan County FSA Committee, which is the control county for individuals B & C, and the Wagoner County FSA Committee, which is the control county for individual A, in order for them to make a determination based on information provided in the audit.

Recommendation No. 2 – Apply the most restrictive rule and collect up to $450,887 in 1997 through 1999 program payments issued to individuals B and C and individual A's corporation as appropriate, if adverse determinations are made for Recommendation No. 1.

Based on the determination made at the joint committee meeting, FSA will notify individuals A, B, and C, of the amount of repayment required.

If additional information is required at this time, please advise.

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ABBREVIATIONS

AMTA	Agriculture Marketing Transition Act
CED	County Executive Director
COC	County Office Committee
CPA	Certified Public Accountant
FACT ACT	Food, Agricultural, Conservation, and Trade Act of 1990
FAIR ACT	Federal Agriculture Improvement and Reform Act of 1996
FSA	Farm Service Agency
FY	Fiscal Year
JV	Joint Venture
LDP	Loan Deficiency Payment
MLA	Marketing Loss Assistance
NL PAYMENT	Payments subject to a $50,000 limitation over the 7-year life of the PFC
OIG	Office of Inspector General
PFC	Production Flexibility Contract
SL PAYMENT	Payments subject to the $40,000 limitation for each year of the PFC