United States General Accounting Office

GAO

Report to the Honorable
J. Robert Kerrey, U.S. Senate

June 1993

NET FARM INCOME

Primary Explanations for the Difference Between IRS and USDA Figures

GAO/GGD/RCED-93-113

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-253395

June 3, 1993

The Honorable J. Robert Kerrey
United States Senate

Dear Senator Kerrey:

In your July 27, 1992, letter, you asked us to review and explain the differences between the net farm income figures reported by the Internal Revenue Service (IRS) and those reported by the U.S. Department of Agriculture (USDA). As you pointed out in your letter, the figures of these two agencies differ by billions of dollars each year. In 1989 (the most recent year for which comparable data were available), IRS showed net farm income at $4.2 billion,[1] while USDA reported it at $49.9 billion—a difference of $45.7 billion. Such a wide disparity between the two figures makes it difficult for data users to determine which figure better measures net farm income.

In this report, we discuss what we believe to be the primary explanations for the difference between IRS and USDA net farm income figures. We are providing these explanations so that data users may better understand how and/or why the differences occur. Because of the limited data available, we were unable to measure the precise impact of each explanation on the overall differences.

Results in Brief

On the basis of our discussions with officials from IRS, USDA, and other agencies and our review of IRS and USDA publications and other documents, we identified the following five primary explanations for the difference between IRS and USDA net farm income figures:[2]

- IRS and USDA figures are developed from two different populations, or universes.
- USDA's net farm income figures include noncash income items that are excluded from IRS' figures.
- IRS and USDA report some sales of livestock differently.
- IRS and USDA account for depreciation differently.
- According to IRS information, IRS' net farm income figures are understated because some tax filers erroneously report farm incomes and expenses.

[1]IRS does not report a net farm income figure that represents all individuals, partnerships, and corporations engaged in farming. Therefore, we had to compile this figure using various tax publications.

[2]While we believe these are the primary explanations for the difference, in their comments to a draft of this report IRS and USDA officials pointed out other factors affecting net farm income. See pp. 11-12.

In addition to understanding how and/or why IRS and USDA net farm income figures differ, data users must exercise caution when using either agency's aggregate figures to portray the financial condition of U.S. farms. Caution is necessary because dependence on any one figure could present a misleading picture of the financial conditions of different groups within the farm sector. For instance, in 1989, individual tax filers reported an aggregate net farm loss of $214 million on their tax returns. However, this aggregate figure did not reflect the fact that the only groups of individual tax filers reporting overall net farm losses were those with adjusted gross incomes of less than $10,000, of $15,000 to $20,000, or of $200,000 or more.

Background

For years, IRS and USDA have been reporting estimates of net farm income,[3] with USDA's figures being higher than IRS'. During the most recent 20-year period for which IRS and USDA have published statistics, the nominal differences in the two net farm income figures have increased substantially from $11 billion in 1970 to almost $46 billion in 1989.[4] Increased differences such as these have led some farmers and farm groups to express concern about the accuracy of the figures.

IRS' net farm income figures are part of IRS' efforts to annually publish "pertinent and valuable" facts related to the operations of U.S. tax laws. IRS' figures do not attempt to provide a complete accounting of all farm-related incomes and expenses. In contrast, USDA's net farm income figures provide a measurement of the economic conditions of the U.S. farm sector, including input from parties that may be only partially involved in farming.

The IRS and USDA Universes Are Not Comparable

To collect data for estimating net farm income, IRS and USDA use different universes—farm tax filers versus farm operations. The IRS universe includes (1) individuals and partnerships that report farm incomes and expenses on IRS' Schedule F and (2) corporations that classify themselves for statistical purposes as agricultural producers. Using such a universe, IRS' net farm income in 1989 was derived from data collected from

[3]Appendixes I and II describe how IRS' and USDA's net farm income figures are compiled.

[4]Appendix III shows, in nominal (unadjusted for inflation) and 1991 dollars, IRS and USDA net farm income figures and the differences between them from 1970 through 1989.

2.5 million farm tax filers.[5] The USDA universe, in contrast, includes only farm establishments from which $1,000 or more of agricultural products either are sold or would normally be sold during a year.[6] Using USDA's universe, net farm income in 1989 represented data collected from 2.2 million farms.

Unlike USDA's universe that includes only farm operations with $1,000 or more in sales, IRS' universe includes tax filers with no minimum on sales. Therefore, tax filers with less than $1,000 in farm sales may be included in IRS' universe. According to a qualified analysis done for us by IRS, about 450,000—or 19 percent—of the individuals filing Schedule F in 1989 reported farm receipts of less than $1,000. Collectively, these individuals reported net farm losses of about $1.75 billion—or $3,900 per tax return.[7]

In contrast, some farm tax filers with annual farm-related sales of $1,000 or more—who are likely to be included in USDA's universe—may be excluded from IRS' universe because they do not have to file federal tax returns. In 1989, a married couple filing jointly with gross income from all sources of less than $9,200 and net self-employment earnings of under $400 was not required to file a tax return. The absence of these types of tax filers from IRS' universe adds to the difficulty of trying to make IRS' and USDA's universes comparable.

Furthermore, while IRS' universe excludes farm incomes and expenses from corporations that classify themselves as something other than agricultural producers, USDA's universe includes farm-related incomes and expenses from corporations, regardless of how the corporations are classified for statistical purposes. Using a 1992 farm magazine article that identified 400 companies with large farm-related sales,[8] we reviewed tax information for specific companies that were in the top 100. On the basis of that review, we found that at least 17 companies, with net income from all sources (including farming) of $935 million, were classified for IRS

[5]Individual tax filers who report net farm rental income or loss file about 0.6 million returns. Because some people reporting farm rental income or loss may also report income directly from farming, we do not know how many of these individuals are included in the 2.5 million figure we cited earlier.

[6]USDA's definition of a farm is identical to that used by the U.S. Department of Commerce for its Census of Agriculture.

[7]These figures represent the only data available on farm receipts of less than $1,000. IRS derived them from a sample of farm income and expense schedules drawn to estimate individual tax filers' net farm incomes and losses. For each return, IRS added a gross income amount and a cost of sales amount to obtain a cash receipts amount. IRS did not verify these amounts for administrative purposes as it does its net farm income and loss figures.

[8]Jennifer Erickson, "Tyson Foods Is Still on Top," Successful Farming (April 1992), p. 20.

purposes as something other than agricultural producers.[9] Thus, the point can be made that a number of companies that have farm-related incomes and losses were not included in IRS' universe of farm tax filers, even though they reportedly had millions of dollars in farm-related sales. Conversely, however, when corporations classify themselves as agricultural producers, IRS' universe reflects all of their incomes and losses, regardless of how much or how little income was generated from farming.

This issue is important because many corporations that are not classified as agricultural producers have agriculture-related work performed through contractual arrangements. In such an arrangement, a farmer could agree to raise a product—for instance, chickens—for a corporation that provides the chicks. Contractual payments received by the farmer would likely be included in both IRS' and USDA's net farm income figures. However, only USDA would also include additional value representing the net income that the corporation would have received had it sold the chickens at the marketplace rather than had it processed them. USDA officials estimate that the net farm income derived from contractual arrangements amounted to $11.3 billion in 1989, $8.2 billion in 1990, and $11.6 billion in 1991. To the extent that this income was received by corporations that were not classified as agricultural producers, it would have been excluded from IRS' net farm income figures.

USDA's Figures Include Noncash Items That IRS Excludes

In compiling its net farm income figures, USDA includes a number of specific noncash items that are excluded from both IRS' farm tax returns and other USDA farm income concepts. USDA justifies including these items on the basis that its net farm income figures represent the net value of all goods and services produced on a farm. Furthermore, USDA includes these items so that its figures will be consistent with the Department of Commerce's gross domestic product (GDP). USDA's figures are the source for the farm sector's contribution to the GDP.

Items included in USDA's net farm income figures but not in IRS' consist of noncash gross income (the value of farm products consumed on the farm

[9]Our study of how these 100 companies were classified for IRS' purposes was limited. We examined an IRS list of agricultural producers with $5 million or more in assets and identified 24 of the 100, accounting for $113 million in net income. We then analyzed IRS' lists of similar-sized companies in 7 subindustries not designated as parts of agricultural production and identified 17 of the 100 companies in our study. Thus, we examined only large-asset companies in certain industries and did not determine how the remaining 59 companies out of the original 100 were classified. According to an IRS official, the lists we examined might not be totally accurate because companies could incorrectly report their industry code.

as food, plus an imputed income for the rental value of the farm dwellings of operators and hired laborers) and the value of changes in livestock and crop inventories during the calendar year. To the extent possible, USDA also identifies the expenses associated with noncash items so that the net effect of the items can generally be estimated. In 1989, noncash items included in USDA's net farm income figure amounted to more than $7 billion—the value of food consumption was $0.7 billion;[10] the net rental value of dwellings, $1.9 billion; and the value of the inventory adjustment, $4.8 billion.

IRS and USDA Treat Some Sales of Livestock Differently

Although sales of livestock are accounted for in USDA's net farm income figures, such sales may or may not be treated as farm income by IRS. If the livestock are held mainly to be sold, IRS includes the sales proceeds in its net farm income figures. However, if the livestock are held for such things as breeding, sport, or dairy purposes, IRS includes the proceeds as sales of business property. Consequently, any gains or losses are excluded from IRS' net farm income figures because they are reported on IRS Form 4797, Sales of Business Property, not on Schedule F.

In 1981, the last year for which IRS published information on sales of livestock as business property, net gains were reported at $2.7 billion. On the basis of that amount, the U.S. Department of Commerce's Bureau of Economic Analysis estimated that in 1989,[11] $3.0 billion in net gains from livestock was included in USDA's net farm income figure but not in IRS' figure.

IRS and USDA Account for Depreciation Differently

Farm-related depreciation is a major expense item included in the calculation of net farm income. In 1989, USDA's net farm income figure reflected a deduction for depreciation of $17.2 billion, whereas Commerce's Bureau of Economic Analysis, using IRS' depreciation figures for before 1981, projected farm-related depreciation for tax purposes for 1989 in such a way that we computed the amount to be $20.4 billion.[12] These differences occurred because the two agencies have different methods for computing depreciation. While USDA measures the economic

[10]This figure represents the gross value of home consumption. To estimate the net value, USDA would have to deduct the associated production expenses, which would be difficult or impossible to separate from the total production expenses.

[11]Each year, the Bureau of Economic Analysis reconciles personal income with adjusted gross income as reported by IRS. Farm proprietors' income is part of that reconciliation.

[12]We were unable to obtain current farm-related depreciation figures from IRS. Therefore, we used Commerce's figures.

life (the amount of time that an asset has some value) and the contribution of the farm-related asset to production, IRS follows definite tax rules that do not necessarily replicate the economic concept.

According to IRS' Farmer's Tax Guide, depreciable property for farm tax purposes includes such items as farm machinery and livestock for dairy or breeding purposes. For each qualifying item, the tax filer may elect to deduct an extra amount of the cost during the year of purchase in addition to the normal depreciation taken. Such deductions are not reflected in USDA's depreciation figures. In 1991, the extra deduction was limited to $10,000 if the total property purchased did not exceed $200,000. Any purchase costs that are not deducted in 1 tax year may be carried over to subsequent tax years and deducted under one of several cost recovery systems.

The depreciation write-off period for each of IRS' depreciation systems can vary depending on the item of property depreciated and the system selected by the tax filer. For example, automobiles may be fully depreciated over 5 years, whereas depreciation periods for farm structures/buildings may range from 10 to 25 years. In contrast, USDA's write-off periods for depreciating items are generally much longer. For automobiles, USDA's write-off period is 13 years; for farm buildings, it is 40 years. USDA officials told us that their agency's write-off periods represent the staff's professional judgment of the life expectancy of the property that is depreciated.

As a further reason for the differences, IRS' procedures require that depreciation be calculated using original purchase prices, but USDA's procedures require that replacement costs be used. In effect, USDA's depreciation figures represent, in current prices, the outlays required by farmers to replace equipment and other capital assets used up during the year.

According to IRS, Tax Filers Understate Net Farm Income

According to IRS, tax filers do not always comply with the Internal Revenue Code when reporting farm incomes and expenses. For example, some tax filers may fail to report stock dividends from farm cooperatives, or they may combine business expenses—which are deductible—with personal expenses—which are not deductible.

As a result of the misreporting of tax items, IRS reported in 1988 that its net farm income figures as well as other income amounts were understated.

For example, IRS estimated that its 1982 farm net income was understated by $8.4 billion. Similarly, it estimated that informal suppliers, such as roadside vendors and moonlighting craftsmen, underreported their income by $37.4 billion. Using those estimates, IRS then projected that 1989 farm net income and income from informal suppliers would be understated by about $11.7 billion and $57.8 billion, respectively.[13] Total income from all sources was projected to be understated by $280 billion. IRS does not know how much of the farming understatement was related to tax filers engaged in full-time as opposed to part-time farming. According to IRS, the actual understatements could be even higher because neither the 1982 farm income estimate nor the 1989 projection included the possible misreporting of rental or capital gains, the potential misreporting by partnerships or corporations, or the possible tax law noncompliance by individuals who failed to file tax returns. On the other hand, IRS may find that its estimated understatements (for example, the $11.7 billion in 1989) are high because the estimates were based on IRS' audit findings and recommendations, some of which could be successfully challenged by tax filers.

Caution Must Be Exercised When Using IRS and USDA Figures

The farming population includes many different segments; therefore, net farm income figures must be used with caution, especially if the figures are used to describe the financial conditions of particular farm groups. Figures from IRS and USDA show that some groups of farmers (categorized by the size of adjusted gross income or by sales class) are profitable, while others are not.

For example, as shown in table 1 for 1989, IRS data indicated that individuals' returns in the groups with adjusted gross income of less than $10,000, of $15,000 to $20,000, or of $200,000 or more were the only groups that collectively reported net farm losses.[14] Moreover, within IRS' highest income group—individual tax filers whose returns showed an adjusted gross income of $1 million or more—3,000 returns showed a total net farm loss of $385 million, while 1,000 returns showed a total net farm gain of $166 million.

[13] Income Tax Compliance Research: Supporting Appendices to Publication 7285, Department of the Treasury, Publication 1415 (1988), p. A-124.

[14] This situation was similar to that reported by IRS for 1987 and 1988 and on a preliminary basis for 1990.

Table 1: Individuals' Net Farm Income as Reported by IRS by Level of Adjusted Gross Income, 1989

Size of adjusted gross income	Number of tax returns	Net farm income in millions
None	129,635	–$2,205
$1 to less than $5,000	168,622	–387
$5,000 to less than $10,000	211,263	–199
$10,000 to less than $15,000	238,995	81
$15,000 to less than $20,000	226,558	–184
$20,000 to less than $25,000	211,996	108
$25,000 to less than $30,000	204,735	129
$30,000 to less than $40,000	305,309	473
$40,000 to less than $50,000	240,411	750
$50,000 to less than $75,000	235,826	924
$75,000 to less than $100,000	76,496	407
$100,000 to less than $200,000	70,293	364
$200,000 to less than $500,000	29,243	–197
$500,000 to less than $1,000,000	6,289	–61
$1,000,000 or more	4,046	–219
All returns	**2,359,718**	**–$214**

Note: Figures are estimates based on samples. Numbers may not add to total due to rounding.

Source: Individual Income Tax Returns, 1989, Department of the Treasury, Publication 1304 (1992), p. 31.

Similarly, as shown in table 2, USDA reported that the category of farms with less than $20,000 in sales—which accounted for nearly 60 percent of all the farms in 1989—showed a total net cash loss of $158 million. On the other hand, for the category of farms with $1 million or more in sales—which accounted for less than 1 percent of all farms—USDA reported a total net cash gain of nearly $18 billion.[15]

[15]We used net cash income as opposed to net farm income in this analysis because USDA's publication Economic Indicators of the Farm Sector, National Financial Summary, 1991 did not have a similar breakdown for net farm income. As we mentioned in appendix II, net cash income differs from net farm income in that it excludes all noncash income, inventory adjustments, noncash expenses, and the income and expenses associated with farm operators' dwellings.

Table 2: Farms' Net Cash Income, as Reported by USDA by Sales Class, 1989

Sales class	Farms: Number	Farms: Percent of all	Total net cash income in millions
Less than $20,000	1,278,000	58.9%	-$158
$20,000-$39,999	265,000	12.2	2,739
$40,000-$99,999	315,000	14.5	8,289
$100,000-$249,999	206,000	9.5	13,843
$250,000-$499,999	67,000	3.1	9,644
$500,000-$999,999	26,000	1.2	6,787
$1,000,000 or more	13,000	0.6	17,777
Total	**2,170,000**	**100.0%**	**$58,921**

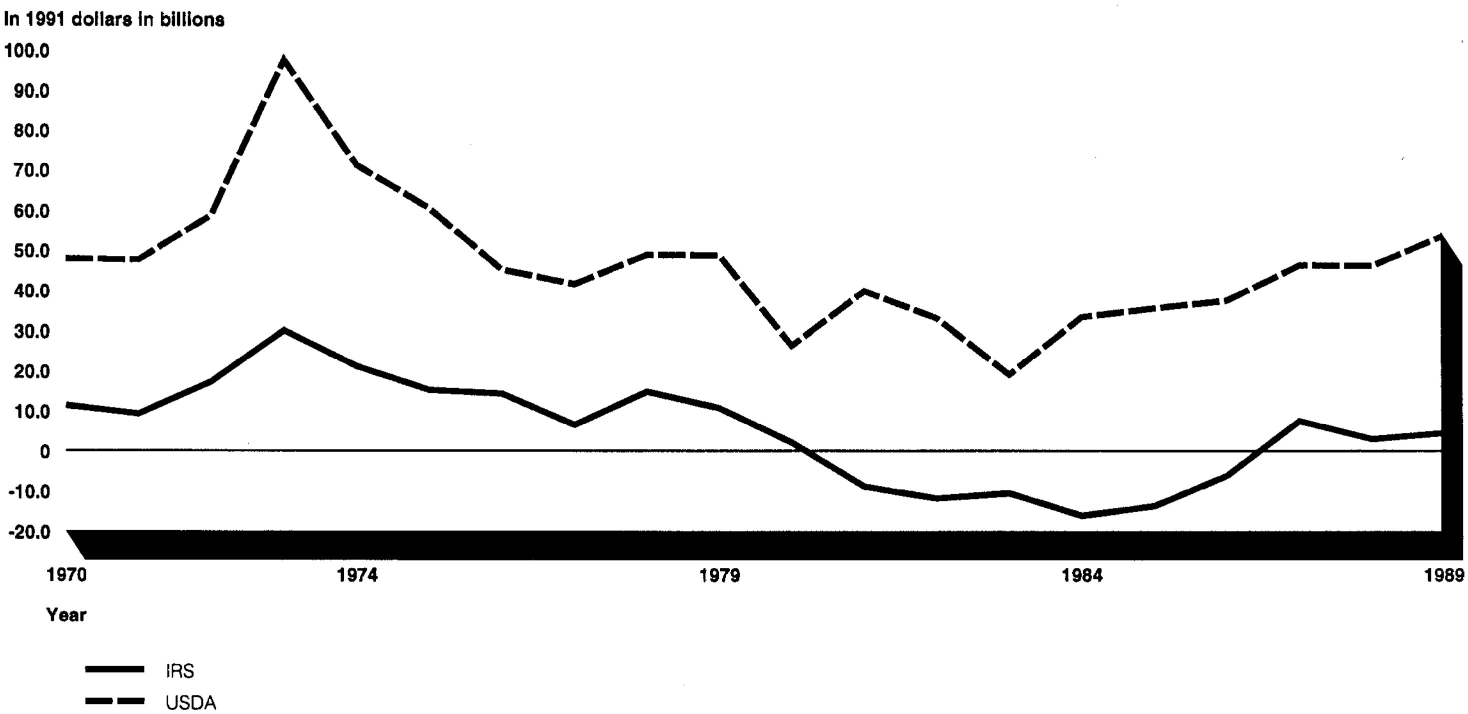
Note: Net cash income excludes all noncash income.

Source: Economic Indicators of the Farm Sector, National Financial Summary, 1991, United States Department of Agriculture (Jan. 1993).

Another similarity between IRS and USDA net income figures occurs as a result of converting the figures to 1991 dollars (using the GDP implicit price deflator) and tracking changes in the figures over time. As figure 1 indicates, changes in IRS' net farm income figures from 1970 through 1989 have generally paralleled the changes in USDA's figures. Consequently, even though the two agencies' yearly figures differ by billions of dollars, the gap between the figures has not changed significantly over time.[16]

[16]Appendix III shows the same information in nominal as well as 1991 dollars.

Figure 1: Comparisons of IRS and USDA Net Farm Income for 1970-89



Source: GAO's calculation of IRS and USDA data.

As a final caution when using IRS and USDA net farm income figures, one must realize that these figures do not represent the total income received by farmers or their complete financial picture. For instance, these figures are incomplete because net farm income does not include income that tax filers derive from sources off the farm. According to a recent article,[17] the 1.3 million individuals' tax returns in 1987 that reported a net farm loss of $12.1 billion also reported off-farm income of $63 billion. For 1989, USDA reported that farm operators and their family members received off-farm cash income of about $57 billion.

[17]Michael Compson and Ron Durst, "IRS Estimates of the Aggregate Net Farm Profit (Loss) of Farm Sole Proprietors," Agricultural Income and Finance (Dec. 1992), p. 13.

Agency Comments and Our Evaluation

We provided both IRS and USDA with a draft copy of this report, and their comments have been incorporated as appropriate. Copies of their written comments are included in appendixes IV and V, respectively.

In its comments, IRS pointed out that the Internal Revenue Code has special provisions applicable to farming that we do not include in our report but that do affect the net farm income reported to IRS. These provisions include rules relating to cash versus accrual methods of accounting, installment sales, sales of farmland with unharvested crop, capitalizing versus expensing of certain expenditures, involuntary conversions of livestock or crops, and farm tax shelters.

While we agree that these provisions affect net farm income, we could not conclude that they were among the primary explanations for the difference between IRS and USDA figures. Although it is difficult to actually quantify how much these provisions contributed to the difference, the information we had led us to believe that either (1) a particular provision had a relatively small effect on the difference compared to the reasons on which we concentrated or (2) the provision was related to explanations we had already included.

USDA, in its comments, agreed with our explanations of the difference between IRS and USDA net income figures and said that the explanations provide data users a basis for understanding why the figures should not be expected to resemble one another. USDA also agreed with our view that an aggregate sectorwide estimate of farm income could be misleading.

However, USDA suggested that we include information about the types of corporations not classified for IRS purposes as agricultural producers. We did not elaborate further because we were wary of disclosing confidential tax data.

USDA also commented that the report does not mention that certain forest products sales are in USDA's net farm income figure but not in IRS'. We did not specifically mention these sales in our report because we could not conclude that they were a primary explanation for the difference between IRS and USDA figures. In 1989, according to a USDA official's analysis of IRS data, filers of Schedule F reported $5.8 billion of gains from the sale of business property. Excluding the $3 billion in gains from the sale of livestock described earlier leaves $2.8 billion in gains from the sale of other business property. However, we did not know how much of this amount covered the sale of farmland, which neither IRS nor USDA counts in net farm income, or the sale of other items, such as forest products. Even different types of forest products are handled differently. For example, when a farmer sells cut timber for firewood, the sale is supposed to be included on Schedule F and therefore in IRS' net farm income computation. The sale of standing timber, however, is not included on Schedule F. For 1981, the last year for which information was available, IRS showed a net gain of $0.6 billion from the sale of standing timber.

Lastly, USDA commented that a table listing the major items and amounts contributing to the difference between IRS and USDA figures may help the casual reader better understand where the differences arise. We agree. However, as we note in the report, data limitations prevented us from measuring the precise impact of each explanation on the overall difference. For this reason, we believe that including such a table in our report could mislead, rather than help, the reader.

We did our work from August 1992 through April 1993 in accordance with generally accepted government auditing standards. Details concerning our objectives, scope, and methodology appear in appendix VI.

As arranged with you, unless you publicly announce its contents earlier, we plan no further distribution of this report until June 7, 1993. After that time, we will send copies to interested Members of Congress; the Secretary of Agriculture; the Secretary of the Treasury; the Commissioner, Internal Revenue Service; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

Major contributors to this report are listed in appendix VII. If you have any questions, please contact me at (202) 272-7904.

Sincerely yours,

Natwar M. Gandhi
Associate Director, Tax Policy and
Administration Issues

Contents

Letter	1
Appendix I Description of How IRS' Net Farm Income Is Compiled	16
Appendix II Description of How USDA's Net Farm Income Is Compiled	18
Appendix III IRS and USDA Net Farm Income Figures, 1970-89	20
Appendix IV Comments From the Internal Revenue Service	21
Appendix V Comments From the U.S. Department of Agriculture	24
Appendix VI Objectives, Scope, and Methodology	26

Appendix VII Major Contributors to This Report 28

Tables

Table 1: Individuals' Net Farm Income as Reported by IRS by Level of Adjusted Gross Income, 1989 8
Table 2: Farms' Net Cash Income, as Reported by USDA by Sales Class, 1989 9
Table I.1: 1989 Farmers' Net Income as Reported to IRS 17
Table II.1: Derivation of USDA's Net Farm Income, 1989 18

Figure

Figure 1: Comparisons of IRS and USDA Net Farm Income for 1970-89 10

Abbreviations

GDP	gross domestic product
IRS	Internal Revenue Service
USDA	U.S. Department of Agriculture

Description of How IRS' Net Farm Income Is Compiled

IRS does not compile a single net income figure for all individuals, partnerships, and corporations engaged in farming. Therefore, we had to compile our own net farm income figure from four IRS published sources.

The first source represents the net farm-related income of individuals who file a Schedule F—the IRS form used to report farm incomes and expenses. Each year, IRS publishes statistics on all individuals' tax returns by income source, one source being the Schedule F for farm income.

The second source we used represents farm rental income for individuals, which IRS aggregates from Form 4835. Individuals file Forms 4835 when they receive farm rental income based on crops or livestock produced by their tenants. Individuals may also file this form if they are landowners or sublessors who do not materially participate in operating or managing the farm.

The third source we used was IRS' annual publication of partnership incomes. Although partnerships do not pay income taxes (leaving that to their partners), they do file annual information returns. These returns show, among other things, net farm profits or losses taken from the Schedule F generally filed with the partnerships' returns. IRS obtains total partnership farm income information by aggregating these farm profits or losses. Partners do not report incomes or losses from farm partnerships on the Schedules F used as our first source; rather, these incomes or losses are reported on a separate form.

The fourth and final source we used was IRS' aggregation of corporate statistics. Every year IRS publishes corporate statistics by industry code. For our work, we focused on industry code 0400—agricultural production—and related income amounts. Unlike the information for individuals and partnerships, however, the statistics for corporations were not limited strictly to the entities' farming business.

Table I.1 shows the net farm income figures that we obtained from these four IRS sources for 1989.

Table I.1: 1989 Farmers' Net Income as Reported to IRS

Dollars in billions

Description of income amount	Amount
Individual farm net income minus farm net loss	–$0.2
Individual farm rental net income minus net loss	2.4
Partnership farm net profit minus farm net loss	0.7
Corporate agricultural production net income (less deficit)	1.3
Total	**$4.2**

Note: Figures are estimates based on samples.

Sources: Department of the Treasury data.

Description of How USDA's Net Farm Income Is Compiled

USDA has been publishing gross and net farm income estimates since 1913. Currently, USDA publishes estimates under five major income concepts. These concepts represent the income earned by all farm operations and provided to individuals who share in the risks associated with production. The five major income concepts are net farm income, net cash income, net business income, net cash flow, and returns to operators.

Broadly defined, USDA's net farm income concept measures the accounting profit from current-year production of commodities, whether or not they were sold from the farm, and the value of services generated by dwellings located on farms. USDA's net farm income represents the difference between gross cash/noncash farm incomes and cash/noncash production expenses, derived as shown in table II.1 for 1989.

Table II.1: Derivation of USDA's Net Farm Income, 1989

Dollars in billions

Income/expense items	Dollars
Income items	
Gross cash income	
Cash receipts	$161.0
Direct government payments	10.9
Farm-related income	8.2
Noncash income	
Home consumption	0.7
Gross imputed rental value of all farm dwellings	5.5
Value of change in inventory	4.8
Total income	**$191.1**
Expense items	
Cash expenses	
Intermediate production expenses	$84.3
Taxes	5.1
Interest	14.7
Contract and hired labor expenses	11.1
Net rent to nonoperator landlords	8.2
Capital consumption	
Depreciation	17.2
Accidental damage	0.6
Total expenses	**$141.2**
Net farm income—income minus expenses	**$ 49.9**

USDA's other four farm income concepts use the same data used to estimate net farm income but with certain variations. Returns to operators is similar to net farm income except that the farm operators' dwelling components are excluded; net cash income and net cash flow exclude all noncash income, inventory adjustments, noncash expenses, and the income and expenses associated with operators' dwellings; and net business income is gross cash income less cash expenses and capital consumption. According to USDA's National Financial Summary, 1991, net business income provides a measure of income that is conceptually similar to the net income from farming reported to IRS.[1]

USDA calculates its farm income and expense estimates from a variety of sources. Cash receipts and inventory adjustment figures are based on information collected by USDA's National Agricultural Statistics Service; direct government payments come from USDA's Agricultural Stabilization and Conservation Service; and other gross income and production expense figures come from the U.S. Department of Commerce's Census of Agriculture, USDA's Farm Costs and Returns Survey, other government agencies, and private industry. Most of USDA's production expense figures are benchmarked to figures reported in the Census of Agriculture. However, because the census is conducted only every 5 years—1987 being the most recent year for which information was published—USDA's expense figures based on census data are moved between census benchmarks using the most appropriate data that help determine the direction and size of the change.

[1]For 1989, USDA reported net business income at $43 billion—about $7 billion less than its net farm income figure. While we could have used USDA's net business income figure in this report to explain the differences between IRS' and USDA's figures, we used the net farm income figure because it provides the broadest definition of net income and is the oldest and most widely recognized of USDA's farm income concepts.

IRS and USDA Net Farm Income Figures, 1970-89

Dollars in billions

Year	IRS' net farm income		USDA's net farm income		Differences between IRS' and USDA's net farm income	
	Dollars		Dollars		Dollars	
	Nominal	1991	Nominal	1991	Nominal	1991
1970	$3.4	$11.3	$14.4	$47.8	$11.0	$36.5
1971	2.9	9.2	15.0	47.5	12.1	38.3
1972	5.7	17.2	19.5	58.7	13.8	41.5
1973	10.6	30.0	34.4	97.5	23.8	67.5
1974	8.1	21.1	27.3	71.1	19.2	50.0
1975	6.4	15.2	25.5	60.6	19.1	45.4
1976	6.4	14.3	20.2	45.2	13.8	30.9
1977	3.1	6.5	19.9	41.6	16.8	35.1
1978	7.6	14.8	25.2	48.9	17.6	34.1
1979	6.0	10.7	27.4	48.8	21.4	38.1
1980	1.3	2.1	16.1	26.3	14.8	24.2
1981	–6.0	–8.9	26.9	39.9	32.9	48.8
1982	–8.5	–11.9	23.8	33.2	32.3	45.1
1983	–7.9	–10.6	14.2	19.1	22.1	29.7
1984	–12.6	–16.2	26.1	33.5	38.7	49.7
1985	–11.1	–13.8	28.8	35.7	39.9	49.5
1986	–5.1	–6.2	31.1	37.6	36.2	43.8
1987	6.4	7.5	39.7	46.4	33.3	38.9
1988	2.7	3.0	41.1	46.3	38.4	43.3
1989	4.2	4.5	49.9	53.9	45.7	49.4

Note: IRS figures are estimates based on samples. USDA figures are derived as described in appendix II.

Sources: GAO computations using Department of the Treasury data and USDA's National Financial Summary, 1991, table 3.

Comments From the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

JUN 3 1993

Mr. Johnny C. Finch
Assistant Comptroller General
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr Finch,

Thank you for the opportunity to comment on the GAO draft report on net farm income. The following information is provided for your consideration as you finalize the report.

On page 2 of the draft report, you mention the capital gains treatment applicable to farm livestock held for breeding purposes. However, you may also wish to reference other special rules in the Internal Revenue Code that are applicable to farming businesses that affect the net farm income reported to the IRS. Some of the more significant provisions include:

1) Use of cash versus accrual methods of accounting;
2) rules applicable to installment sales;
3) tax treatment of sales of farmland with an unharvested crop;
4) capitalizing versus expensing certain farm expenditures, including conservation expenses, land clearing expenses, developmental costs, and the cost of fertilizer;
5) rules applicable to "involuntary conversions" of livestock or crops; and
6) treatment of farm "tax shelters", including the limitations on profits caused by "passive losses".

Now on page 3, footnote 5. See comment 1.

On page 4, regarding the differences in the farming universes between IRS and the USDA, you may wish to mention that the IRS universe also includes farm income and expenses reported on Form 4835 (Farm Rental Income and Expenses), which is alluded to in footnote 4.

Now on page 3, footnote 7. See comment 2.

On page 5, you may wish to clarify footnote 6 by rewording the last sentence to read: "IRS did not verify these amounts for administrative processing purposes as it does for its net farm income and loss figures."

-2-

Mr. Johnny C. Finch

Now on page 3. See comment 3.

On page 6, we recommend that you revise the sentence that appears at the top of the page to read "...regardless of how the corporations are classified for IRS statistical purposes."

Now on page 4. See comment 4.

On page 7, the draft report states that "...income such as salary received by the farmer would likely be included in both IRS' and USDA's net farm income figures." This is not the case for the IRS; a salary received by a farm proprietor is not included in IRS farm profit statistics.

Now on page 16. See comment 5.

In Appendix I, page 22, you may wish to clarify that the partnership does the aggregating of Schedule F data, not the IRS. The partnership enters the totals from the attached schedule F onto page 1 of the Form 1065 as "net farm profit (loss)".

Again, thank you for the opportunity to offer our comments on this draft report. We hope you find them helpful.

Sincerely,

for Margaret Milner Richardson

The following are GAO's comments on the Internal Revenue Service's letter dated June 3, 1993.

GAO Comments

1. Clarified footnote.

2. Clarified footnote.

3. Made change.

4. Replaced the word salary with contractual payments.

5. Clarified.

Comments From the U.S. Department of Agriculture

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

MAY 21 1993

Mr. John W. Harman
Director
Food and Agriculture Issues
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Harman:

Thank you for the opportunity to comment on the draft report entitled Net Farm Income: Primary Explanations for the Difference in IRS' and USDA's Figures. The Department of Agriculture (USDA) believes it is important that data users be given as much information as possible on why differences exist between USDA estimates and those prepared by other agencies and departments.

We agree with the explanations provided by the General Accounting Office (GAO) and believe they provide data users a basis for understanding why USDA and Internal Revenue Service (IRS) estimates of income should not be expected to resemble one another with respect to the amount of net farm income reported for the farm sector of the U.S. economy. As the report points out, IRS income data are not intended to measure the total income earned by farm operators from the production of agricultural commodities. USDA net farm income estimates, on the other hand, are able to provide a perspective about the economic performance of the farm sector in its entirety.

We suggest that the report would be strengthened by making the following additions:

Universe for IRS and USDA Estimates--Misclassification of Farms

Given the amount of farm income which is accounted for by large farms, the misclassification of farm corporations could be an important element in explaining the difference between USDA and IRS estimates. The description of GAO's effort to identify these farms could be expanded to offer a more comprehensive statement regarding the implications of the IRS classification method. Based on our understanding of GAO's effort to locate these farms, it seems reasonable to conclude that 76 of the top 100 farms were not considered farms for IRS purposes. The concluding sentence that "a number of companies that have farm-related incomes and losses are not included in IRS' universe" also seems too important to be relegated to a footnote. We also think it would be helpful for data users to know something about the types of farming operations that chose to report their earnings in other sectors of the economy for tax reporting purposes and suggest this information be provided.

Mr. John W. Harman 2

Forest Product Sales by Farmers

The report indicates that certain assets used in a trade or business by farmers, primarily breeding and dairy livestock, are not included in the IRS' estimate of net farm income. However, the report fails to mention that certain forest product sales, which are included in USDA's estimate, are also not included in the IRS estimate of net farm income. A large portion of the forest product sales by farmers is eligible for capital gains treatment and would be reported on Schedule D or Form 4797 as opposed to Schedule F as farm income. In 1989, USDA estimates that forest product sales were approximately $2.1 billion.

Table of Reconciliation

USDA recommends that GAO include a table that lists the major items contributing to differences between USDA and IRS estimates and the amount that each is estimated to contribute to reconciling the differences. This would provide a concise summary and may help the casual reader better understand where differences arise.

In summary, USDA agrees with GAO's view that use of an aggregate sector-wide estimate to assess the financial well-being of different groups of farmers and ranchers within the farm sector could be misleading. For this reason, USDA has designed and implemented an annual survey of farm costs and returns. This survey provides a means for estimating incomes of farm households and farm businesses and for addressing distributional issues within a highly diverse agricultural community.

Sincerely,

Keith Collins

Keith Collins
Acting Assistant Secretary
for Economics

Objectives, Scope, and Methodology

Our objectives were to (1) review and explain the primary differences in IRS' and USDA's net farm income figures and (2) determine whether IRS' and USDA's figures would reveal different financial conditions for farmers when broken down into low- and high-income/sales groups or when tracked over time.

To meet our first objective, we analyzed the composition of the net income figures by reviewing IRS publications showing the income of individuals, partnerships, and corporations engaged in farming and USDA publications identifying different farm income concepts and their income and expense components. To enhance our understanding of these publications and learn more about differences between the figures of the two agencies, we interviewed officials from IRS and from USDA's Economic Research Service and National Agricultural Statistics Service.

Because USDA compiles and publishes net farm income statistics for the nation as a whole and IRS does not, we had to compile net farm income figures for IRS using the methodology described in appendix I. In analyzing our figures, we obtained various supplementary statistics and other data from IRS. To the extent possible, we used data for 1989, as that was the most recent year for which comparable data from IRS and USDA were available. We did not verify the accuracy of IRS' and USDA's published figures, nor did we evaluate the basis for IRS' information on taxpayer compliance or USDA's methodologies for collecting farm information through questionnaires and state-based data gathering techniques.

We further explored the differences between IRS' and USDA's net farm income figures by reviewing articles and other publications that addressed them. Also, we spoke with officials from the Department of Commerce's Bureau of the Census, who compiled net farm income figures from the 1987 Census of Agriculture, and the Bureau of Economic Analysis, who compile annual statistics for Commerce's national income and product accounts.

To meet the first segment of our second objective—that of disaggregating IRS' and USDA's income figures—we examined disaggregation analyses that had been completed by the two agencies. As part of this effort, we identified the extent to which individual tax filers and farm operations in various income groups (by adjusted gross income for IRS and net cash income for USDA) had reported net farm incomes and net farm losses. To meet the remaining segment of our second objective—that of tracking changes in IRS' and USDA's net farm income figures over time—we converted the agencies' nominal figures as reported in appendix III of this report to 1991 dollars, using the GDP implicit price deflator.

Major Contributors to This Report

General Government Division, Washington, D.C.

Jose R. Oyola, Assistant Director, Tax Policy and Administration Issues
Lawrence M. Korb, Evaluator-in-Charge

Resources, Community, and Economic Development Division, Washington, D.C.

Luther L. Atkins, Jr., Assistant Director, Food and Agriculture Issues
Dennis J. Parker, Assignment Manager
Juanita Y. Thurman, Evaluator

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066.

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100