

GAO

United States General Accounting Office

Report to the Joint Committee on
Taxation
Congress of the United States

July 1986

**TAX
ADMINISTRATION**

**Information Returns
Should Increase Proper
Reporting of Farm
Income**





United States
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General Government Division

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The Honorable Bob Packwood
Chairman, Joint Committee on Taxation

The Honorable Dan Rostenkowski
Vice Chairman, Joint Committee on Taxation
Congress of the United States

This report, in response to your Committee's request, discusses the need to improve taxpayer compliance in reporting taxable commodity credit loan and crop insurance income. The report proposes ways for the Internal Revenue Service to better detect unreported income from these sources.

As arranged with your Committee, we are sending copies of this report to other congressional committees; the Director, Office of Management and Budget; the Secretary of the Treasury; the Secretary of Agriculture; the Commissioner of Internal Revenue; and other interested parties.

A handwritten signature in cursive script that reads "W. J. Anderson".

William J. Anderson
Director

Executive Summary

Purpose

The Congress and the administration are concerned about taxpayer non-compliance which results in lost tax revenues. The Internal Revenue Service (IRS) recently estimated that in 1986 over \$90 billion in taxes would be lost. Noncompliance in the farm income area has contributed to lost tax revenues. IRS' most recent study involving farm sole-proprietor tax returns estimated that in 1981 taxes were underpaid by over \$2.5 billion.

In response to a Joint Committee on Taxation request, GAO studied whether noncompliance with farm income reporting requirements was still a problem. Since taxpayers receive more than a billion dollars of commodity credit loan and crop insurance income each year, GAO focused on whether such income was being properly reported.

Background

To improve and stabilize farm income and to protect against economic ruin caused by natural disasters, the Congress established two government corporations that operate under the auspices of the U.S. Department of Agriculture. The Commodity Credit Corporation, using the personnel and facilities of the Department of Agriculture's Agricultural Stabilization and Conservation Service, provides commodity credit loans to protect farm income and stabilize farm commodity prices. The Federal Crop Insurance Corporation offers insurance against economic losses caused by drought, frost, infestation, and other natural disasters.

During periods of low commodity prices, financial assistance may be obtained through a commodity credit loan by pledging crops as collateral. If the market price remains less than the loan's value, the obligation may be liquidated by forfeiting the collateral to the Commodity Credit Corporation. In such a case, the loan proceeds are considered taxable income which the taxpayer has the option of reporting either in the year received or in the year the collateral was forfeited. (See p. 8.)

Crop insurance can be purchased to protect against economic ruin caused by natural disasters. As with commodity credit loan income, crop insurance proceeds are considered taxable and taxpayers have an option regarding the year in which to report the income. (See p. 9.)

IRS requires taxpayers to report loan and insurance income on specific lines of their tax returns. Because tax year 1983 returns, filed during calendar year 1984, were the latest available at the time of GAO's review, and because taxpayers have reporting year options, GAO's review was necessarily limited to crop year 1982 loans and insurance payments.

Results in Brief

Millions of dollars of taxable crop year 1982 loan and insurance income were not reported. Most of the income that GAO projected as unreported was attributable to nonfilers. Furthermore, although the correct taxes may have been paid, over three-quarters of the sampled recipients who filed individual returns did not properly report these types of income.

Proper reporting of crop loan and insurance income should increase soon as should IRS' ability to detect unreported income from these sources. Agricultural agencies are taking steps to send both taxpayers and IRS information returns reporting this taxable income. To make the most efficient and effective use of these information returns, IRS needs to take some actions.

Principal Findings

Taxpayer Noncompliance

GAO's sample of taxable crop loan and insurance income showed that:

- 58, or about 7 percent, of the 795 recipients did not file their required federal income tax returns (see p. 14), and
- 359, or about 77 percent, of the 465 individual taxpayers whose returns GAO reviewed did not properly report the income. (See p. 16.)

GAO projected its sample results to \$714 million of the \$2.3 billion of crop year 1982 liquidated loans, and to \$163 million of the \$459 million of crop year 1982 insurance payments. For this subset, GAO projects that recipients of more than 5,250 commodity credit loans and crop insurance payments representing \$53 million of income did not file 1982 and/or 1983 tax returns. Without tax returns, GAO cannot estimate the associated lost tax revenues.

Regarding the taxpayers who reported their income improperly, GAO's analysis of the results achieved from IRS' limited follow-up with 84 of the 359 taxpayers GAO identified showed that 76 percent of the taxpayers described methods of reporting that IRS considered improper but which may not have affected the taxpayers' overall tax liabilities. IRS determined that the other 24 percent of the taxpayers underreported their income and thereby inappropriately reduced their taxes. Because of sampling limitations the effect of this underreporting can be projected only for part of the loan income in three states. Thus, GAO's projection applies to \$106 million of the \$714 million in liquidated loans in

the national sample partial universe. Accordingly, GAO projects that recipients of more than 150 crop year 1982 liquidated loans underreported their loan income by about \$1.9 million, resulting in lost tax revenues of \$215,000. (See p. 18.)

IRS Actions Needed

Computer matching of information returns with tax returns should help IRS to determine in a cost-effective manner whether the income was properly reported and the applicable taxes were assessed. The understated tax liabilities identified in GAO's sample were 51 times greater than the estimated cost of operating a computer matching program on all of the sample cases. (See pp. 20 to 22.)

To effectively computer match tax returns with information returns showing commodity credit loan and crop insurance income, IRS needs to improve its forms, filing instructions, and computer programs. (See p. 22.) IRS also needs to develop procedures for handling taxpayer income reporting options. (See p. 24.)

Recommendations

To help improve compliance in the reporting of commodity credit loan and crop insurance income, GAO recommends that the Commissioner of Internal Revenue

- clarify instructions and forms concerning commodity credit loan and crop insurance income so that taxpayers and IRS can more efficiently and effectively use information returns, and
- incorporate commodity credit loan and crop insurance income into IRS' document matching program. (See p. 25.)

Agency Comments

The Secretary of Agriculture commented that the report was favorably received and considered technically correct. (See app. V.)

IRS agreed with GAO's first recommendation and has already taken some steps to clarify the information return forms and instructions concerning commodity credit loan and crop insurance income. IRS disagreed, however, with GAO's recommendation to incorporate commodity credit loan and crop insurance information returns into IRS' document matching program. IRS reasoned that existing statutory rules allowing taxpayers to report commodity credit loan and crop insurance income in either of two years presents serious administrative problems for

matching. IRS said that, instead, it will use the information returns in its examination program. (See app IV)

GAO concurs that document matching problems would occur but believes that IRS can overcome them by using the alternatives suggested on pages 24 and 25 or by other means. IRS' plan for using the information returns in its examination program will not be as effective in dealing with the problem of unreported income as a matching program would be. IRS' plan should help to identify individuals who underreport their income on the small percentage of returns IRS examines. However, since the examination program deals only with filed returns, IRS' plan will not result in the identification of nonfilers. Nonfilers accounted for a substantial amount of the unreported income GAO identified. (See pp 26 and 27.)

Contents

Executive Summary	2
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Chapter 1	8
Introduction	8
Income From Commodity Credit Loan and Crop Insurance Programs	8
Objectives, Scope, and Methodology	10

Chapter 2	14
Information Returns	14
Should Help Assure	16
That Taxpayers	19
Properly Report	25
Commodity Credit	25
Loan and Crop	25
Insurance Income	25
Some Recipients of Commodity Credit Loan and Crop Insurance Income Did Not File Tax Returns	14
Loan and Insurance Income Was Frequently Reported Improperly	16
Information Returns Required by Law Should Increase Compliance	19
Conclusions	25
Recommendations	25
Agency Comments and Our Evaluation	25

Appendixes	28
Appendix I. Sampling Methodology and Statistical Projections	28
Appendix II. Schedule F (Farm Income and Expenses)	33
Appendix III. Form 4835 (Farm Rental Income and Expenses)	35
Appendix IV. Advance Comments From the Commissioner of Internal Revenue	37
Appendix V. Advance Comments From the Secretary of Agriculture	38

Tables	9
Table 1 1. Commodity Credit Loan Volume	9
Table 1 2. Crop Insurance Payment Volume	10
Table 2.1. Income Recipients Who Did Not File Returns	15
Table 2.2. Income Improperly Reported by Taxpayers	17
Table 2 3. IRS Follow-Up Results on Improperly Reported Income	17
Table 2 4. Taxpayers' Responses to IRS on Income Reporting Methods	19
Table 2 5. Comparison of Information Return Matching Costs and Revenues for Sampled Income	22

Table I.1. Crop Year 1982 Projected Loan Universe	31
Table I.2. Stratified FCIC Indemnity Payment Universe and Number of Sample Payments Selected	32

Figures

Figure 2.1. Projected Crop Loan and Insurance Income Received by Nonfilers	16
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Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
FCIC	Federal Crop Insurance Corporation
GAO	General Accounting Office
IRP	Information Returns Program
IRS	Internal Revenue Service

Introduction

Over the years, the Congress and the administration have become increasingly concerned over a decline in taxpayer compliance resulting in lost tax revenues. The Internal Revenue Service (IRS) recently estimated that in 1986 taxes would be underpaid by over \$90 billion. In the past, noncompliance in the farm income area has contributed to lost tax revenues. IRS' most recent study involving farm sole-proprietor tax returns estimated that in 1981 taxes were underpaid by over \$2.5 billion.

We studied whether noncompliance with farm income reporting requirements was still a problem. Since taxpayers receive more than a billion dollars of commodity credit loan and crop insurance income each year, we focused on whether such income was being properly reported.

Income From Commodity Credit Loan and Crop Insurance Programs

To improve and stabilize farm income and to protect farmers against economic ruin caused by natural disasters, the Congress established two government corporations within the Department of Agriculture. The Commodity Credit Corporation, using the personnel and facilities of the Department's Agricultural Stabilization and Conservation Service (ASCS), provides commodity credit loans to protect farm income and to stabilize farm commodity prices. The Federal Crop Insurance Corporation (FCIC) offers insurance against economic losses caused by drought, frost, infestation, and other natural disasters.

Commodity Credit Loans

During periods of low commodity prices, farmers may wish to delay selling their crops in hopes commodity prices will rise. In the meantime, farmers may obtain financial assistance through a commodity credit loan by pledging their crops as collateral. As commodity prices rise, farmers can repay their loans, redeem their collateral, and then sell their crops. Under the tax code, the proceeds of the sale are taxable income.

However, if prices remain low, farmers may decide to "liquidate" their loans, i.e., settle their debts by forfeiting their collateral to the lender. In that event, the loan amounts become taxable income.

Crops are sometimes pledged as collateral in one tax year but sold or liquidated in a subsequent tax year. In these instances the tax code permits a taxpayer to report crop loan proceeds as income in the year of receipt, rather than in the year of crop sale or loan liquidation. To make this election, a taxpayer must attach a statement to the tax return filed for the year that the loan was received. The statement should indicate

an election to report the loan proceeds as income and should show the loan amount, the year of receipt, and the quantity and type of commodity pledged as collateral.

IRS requires that crop income, including loan proceeds, be reported either on Schedule F (Farm Income and Expenses) or on Form 4835 (Farm Rental Income and Expenses).¹ See appendixes II and III for reproductions of Schedule F and Form 4835, respectively. Income from loans under election or liquidated loans is generally to be reported on a specific line designated for commodity credit loan income. On the other hand, income from actual crop sales is generally to be reported on a different income line provided for the specific crop involved.

As shown in table 1.1, liquidated commodity credit loans for crop years² 1982, 1983, and 1984 totaled almost \$4.3 billion.

Table 1.1: Commodity Credit Loan Volume

Dollars in millions				
Crop Year	Outstanding	Repaid	Liquidated	Total
1982	\$2,012	\$7,832	\$2,324	\$12,168
1983	749	3,007	1,100	4,856
1984	3,285	3,248	852	7,385
Totals	\$6,046	\$14,087	\$4,276	\$24,409

Note: Amounts shown as repaid and liquidated are for the crop year, not the year of repayment or liquidation.

Crop Insurance Payments

FCIC offers insurance through two basic delivery systems—sales and service agencies called “master marketers” and commercial insurance companies. FCIC pays the claims on policies sold by master marketers in its name, commercial insurers sell crop insurance and pay claims under their own names. To protect themselves from extraordinary losses, commercial insurers may obtain reinsurance from FCIC. Crop insurance claims paid by FCIC and commercial insurers, as shown in table 1.2, totaled about \$1.7 billion for crop years 1982, 1983, and 1984.

¹ Form 4835 is for landowners or sublessors who did not materially participate in the operation or management of the farm. Corporations are to report commodity credit loan income along with other miscellaneous income types on the “other income” line of Form 1120.

²The term “crop year” refers to the year in which the crop is harvested.

Table 1.2: Crop Insurance Payment Volume

Dollars in millions			
Crop year	FCIC	Commercial insurers	Total
1982	\$459	\$69	\$528
1983	405	177	582
1984	255	377	632
Totals	\$1,119	\$623	\$1,742

Like liquidated crop loans, insurance proceeds received under FCIC and commercial insurance programs are considered income and generally must be reported on a specific line of Schedule F or Form 4835.³ Similarly, if the income is received in a year other than the year in which the crop would normally be sold, taxpayers may elect to report the income in either year. To postpone reporting the income in the year that the crops would normally have been sold, taxpayers must attach to their tax return, for the year that the destruction or damage took place, a statement of their intent. The statement is to include

- the specific crops destroyed or damaged,
- the cause of destruction and the date that it occurred,
- the total amount of insurance payments received, itemized for each crop, and the date each payment was received; and
- the name of the insurance carrier or carriers from whom the payments were received

Objectives, Scope, and Methodology

Our primary objectives were to (1) determine whether taxpayers were properly reporting commodity credit loan and crop insurance income and (2) identify methods, if appropriate, for improving taxpayer compliance and increasing IRS' effectiveness in detecting unreported farm income.

We performed our work between July 1984 and September 1985 in accordance with generally accepted government auditing standards. We conducted work at IRS' National Office in Washington, D.C., its Western Region in San Francisco, its district offices in San Francisco and San Jose; and its Fresno, Ogden, Atlanta, Austin, Cincinnati, Kansas City,

³Corporations are to report crop insurance income, like commodity credit loan income, on the "other income" line of Form 1120.

and Memphis Service Centers. We also conducted work at FCIC's Computer Service Center and ASCS's Management Office in Kansas City and at various ASCS county offices throughout the country.

To determine the compliance rate for crop loans and insurance payments, we selected a random sample of

- crop year 1982 commodity credit loans liquidated in tax years 1982 or 1983, and
- crop year 1982 federal crop insurance indemnity payments received during calendar year 1982.

We then requested IRS records for the recipients of sampled crop loans and insurance payments. We discovered that some recipients in our sample apparently did not file 1982 and/or 1983 income tax returns. IRS collection personnel reviewed those cases and verified that the recipients did in fact have either a business or an individual return filing requirement⁴.

Next we compared the income reported on the returns that we did obtain to the crop loan or insurance income amount received by the recipients in our sample. IRS returns processing personnel corresponded with a portion of those taxpayers filing individual returns that were identified as potential underreporters and computed the additional taxes due from those taxpayers who did not respond or who acknowledged that they were underreporters. If the taxpayers explained that, in preparing their tax returns, the income was accounted for in some way, IRS accepted their explanations for the purpose of our study and did not attempt to further verify that the income was actually reported.

Although we selected a sample to be projected nationally, the taxpayer's choice of reporting years, the unavailability of some tax returns, and the limitation of follow-up to a portion of potential underreporters prevented us from making such projections for some of the sample results. Appendix I discusses our sampling methodology in detail and the limits on our projections.

To identify methods for improving taxpayer compliance and increasing IRS' effectiveness, we reviewed available studies and other research.

⁴In this report we use the term "business returns" to refer to returns filed by concerns other than sole proprietors, such as corporations and partnerships. We use the term "individual returns" to refer to sole proprietors' returns.

material dealing with farm income taxation and analyzed IRS management information reports. We also interviewed

- IRS headquarters personnel familiar with farm income taxation;
- IRS regional and service center personnel responsible for auditing tax returns showing farm income;
- commercial insurance company officials familiar with their companies' information return filing procedures; and
- tax practitioners, academicians, and others inside and outside government who are familiar with farm income tax laws.

Information Returns Should Help Assure That Taxpayers Properly Report Commodity Credit Loan and Crop Insurance Income

Millions of dollars of liquidated commodity credit loan and crop insurance income either were not reported or were improperly reported during tax years 1982 and 1983. Our analysis of sampled liquidated commodity credit loans and federal crop insurance payments showed that (1) 58 of 795 recipients (7 percent) did not file their required income tax returns and (2) 359 of 465 recipients (77 percent) whose individual tax returns we reviewed did not properly report the income.

IRS followed up with 84 of the 359 taxpayers who did not report the income properly. IRS determined that 20 of the 84 (24 percent) underreported their crop loan or insurance income and thereby inappropriately reduced their taxes. The other 64 taxpayers (76 percent) described reporting methods that IRS considered improper, but they might not have affected their total tax liability.

Proper reporting of crop loan and insurance income should increase soon, as should IRS' ability to detect unreported income from crop loans and insurance payments. As required by the Internal Revenue Code, agricultural agencies are taking steps to send taxpayers and IRS information returns for these types of income. Generally, information returns detail the type and the amount of income received and should act as a reminder to taxpayers to report the income.

If matched against tax returns, moreover, information returns should help IRS to determine whether the income was properly reported and the applicable taxes were assessed. The costs of operating computer matching programs for crop loan and insurance income should be small compared to the additional taxes that would be assessed.

However, to make the most of commodity credit loan and crop insurance information returns, IRS needs to improve information return forms, filing instructions, and computer programs and to develop procedures for handling optional year reporting.

Some Recipients of Commodity Credit Loan and Crop Insurance Income Did Not File Tax Returns

We requested tax year 1982 and 1983 returns for 795 individuals or businesses that received income from our sampled crop loans and insurance payments. After reviewing IRS records, we found that IRS had not received a number of the returns that we had requested. IRS reviewed these cases and confirmed that of the 795 recipients, 58 (7 percent) were nonfilers, i.e., they did not file their individual or business tax returns, as required. These 58 nonfilers, as shown in table 2.1, received about \$1.4 million in commodity credit loan and crop insurance income.

Chapter 2
**Information Returns Should Help Assure
That Taxpayers Properly Report Commodity
Credit Loan and Crop Insurance Income**

Table 2.1: Income Recipients Who Did Not File Returns

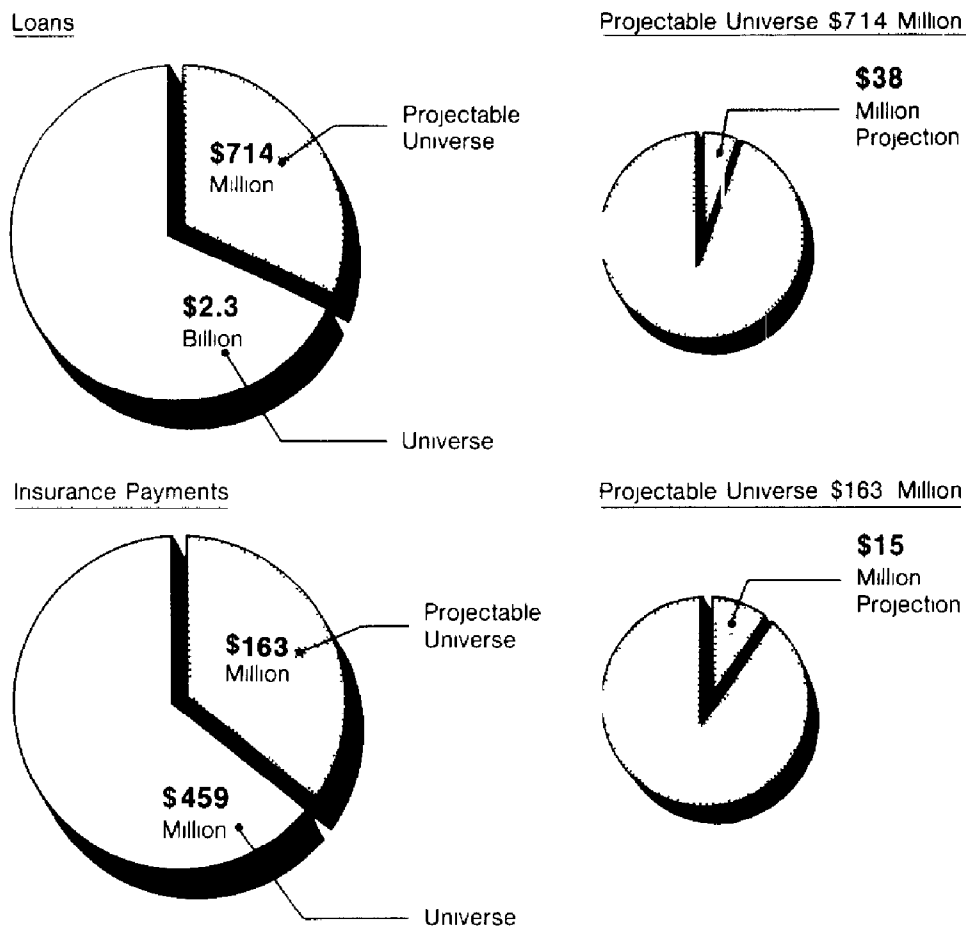
Dollars in thousands

Type of Income	Recipients and dollars received		Nonfilers		Percentage nonfilers	
	No	Amount	No.	Amount	No.	Amount
Loan	431	\$11,358	29	\$ 662	7	6
Insurance	364	9,663	29	733	8	8
Totals	795	\$21,021	58	\$1,395	7	7

Our loan sample can be statistically projected to \$714 million of the \$2.3 billion of liquidated crop year 1982 loans. (See app I.) Accordingly, for that portion of the liquidated loan universe, we estimated that recipients of 3,665 crop loans, representing about \$38 million of income, did not file their tax year 1982 and/or 1983 returns

Similarly, our sample of insurance payments can be statistically projected to \$163 million of FCIC's \$459 million of crop year 1982 insurance payments. Accordingly, for that portion of the insurance payment universe, we estimate that recipients of 1,588 insurance indemnity payments totaling almost \$15 million did not file their tax year 1982 and/or 1983 returns. The total crop loan and insurance payment universes and our projections are displayed in figure 2.1

Figure 2.1: Projected Crop Loan and Insurance Income Received by Nonfilers



At the time that we completed our work, IRS had not completed its follow-up with the identified nonfilers. Without tax returns, we could not estimate the associated lost tax revenues.

**Loan and Insurance
 Income Was Frequently
 Reported Improperly**

The 795 crop loan and insurance income recipients in our sample included both business return and individual return filers. We were able to obtain the individual returns filed by 465 of the sampled recipients, 359 of which, or 77 percent, did not properly report their crop loan or insurance income, i.e., they did not show all their loan or insurance income on the appropriate line of their Schedule F or Form 4835. Improperly reported income, as shown in table 2.2, totaled about \$8 million of the \$10 million paid to the taxpayers in our sample.

Chapter 2
 Information Returns Should Help Assure
 That Taxpayers Properly Report Commodity
 Credit Loan and Crop Insurance Income

Table 2.2: Income Improperly Reported by Taxpayers

Dollars in thousands

Type of income	Taxpayers and dollars reviewed		Improperly reported cases		Percentage of improperly reported cases	
	No.	Amount	No.	Amount	No.	Amount
Loan	258	\$5,632	226	\$5,030	88	89
Insurance	207	4,338	133	2,960	64	68
Totals	465	\$9,970	359	\$7,990	77	80

We asked IRS to correspond with those taxpayers who had erred in reporting and to inquire whether the income was otherwise reported. We also asked IRS to calculate the taxes associated with improperly reported income. Given the concerns that IRS had about the impact that this would have on its resources, we mutually agreed that IRS would limit its follow-up effort to a judgmental selection of 84 taxpayers who had filed returns with IRS' Fresno and Ogden Service Centers. As discussed below, the results of IRS' inquiries indicated that 24 percent of the taxpayers had understated their tax liability. The remaining taxpayers described reporting methods that, although considered improper by IRS, may not have affected their total tax liability.

**Improper Reporting That
 Reduced Tax Liabilities**

Of the 84 taxpayers contacted, IRS determined that 20 (24 percent) had underreported their income by \$214,000. As shown in table 2.3, the underreporting involved approximately \$159,000 in loan income and \$55,000 in insurance income.

Table 2.3: IRS Follow-Up Results on Improperly Reported Income

Dollars in thousands

Type of income	Taxpayers and dollars reviewed		Underreported cases		Percentage of underreported cases	
	No.	Amount	No.	Amount	No.	Amount
Loan	45	\$889	14	\$159	31	18
Insurance	39	701	6	55	15	8
Totals	84	\$1,590	20	\$214	24	13

The underreported income resulted in lost tax revenues of \$51,000—\$34,000 in underreported loan income and \$17,000 in underreported insurance income.

We could not project unreported crop loan or insurance income nationally because of sample limitations (see app. 1). We could, however, statistically project our crop loan sample to \$106 million of the \$333 million of liquidated crop year 1982 loans in three states—California, Nebraska, and Montana. Accordingly, for that portion of the universe, we estimated that recipients of 156 crop year 1982 liquidated loans underreported their loan income by approximately \$1.9 million, resulting in lost tax revenues of \$215,000.

**Improper Reporting That
May Not Have Affected Tax
Liabilities**

In response to IRS' inquiries, the remaining 64 of the 84 erring taxpayers described methods of reporting that IRS considered improper. Almost half of them said that they reported the income on the "crop" or "other" income lines of Schedule F or Form 4835, instead of on the specific loan and insurance lines where the income should have been reported. Examples of other explanations include the following.

- One taxpayer stated that his underreported insurance income equaled his insurance premium expense, for which he did not show a deduction, i.e., he netted the insurance income and premium expense and reported neither.
- A second taxpayer wrote that he had reported only half of his \$5,000 commodity credit loan income because his sister-in-law, who owned half of the property, had reported the other half of the income.
- Another taxpayer said that he had reported his \$11,000 commodity credit loan income on the Schedule F "other income" line in the previous year (the year of receipt), although he had not filed the required election statement.

The taxpayers' responses are summarized in table 2.4.

Chapter 2
**Information Returns Should Help Assure
That Taxpayers Properly Report Commodity
Credit Loan and Crop Insurance Income**

Table 2.4: Taxpayers' Responses to IRS on Income Reporting Methods

Dollars in thousands

Response	Number			Amount		
	Loans	Insurance	Total	Loans	Insurance	Total
Reported on crop or other income lines	23	6	29	\$466	\$163	\$ 629
Reported on business return	3	5	8	140	308	448
Netted insurance premium	•	17	17	•	114	114
Reported on relative's return	1	5	6	5	60	65
Reported in prior or subsequent year without election statement	4	•	4	69	•	69
Totals	31	33	64	\$680	\$645	\$1,325

Note: The sum of the \$1,325,000 reported (table 2.4) and the \$214,000 underreported (table 2.3) does not equal the \$1,590,000 of income reviewed (table 2.3) because four of the underreporters did report part of the income they received.

For the purpose of our study, IRS accepted the taxpayers' responses without further follow-up. Therefore, the effect of the incorrect reporting on the total taxes owed is unclear. However, the most common responses taxpayers gave for not correctly reporting their income suggest that the misreporting may have had no effect on their taxes. For example, 74 percent of the taxpayers said that they reported their commodity credit loan income on the wrong Schedule F line, and 52 percent of the insurance recipients said that they netted their insurance income and premium expenses.

**Information Returns
Required by Law
Should Increase
Compliance**

To meet existing legal requirements, ASCS and FCIC plan to issue information returns on liquidated crop loans and insurance payments. These information returns should help taxpayers to comply with reporting requirements by informing them of the proper reporting method. Furthermore, IRS can use these returns to identify potential nonfilers and underreporters. However, some preparation will be necessary for IRS to make the best use of these returns.

**The Internal Revenue Code
Requires Information
Returns**

The Internal Revenue Code requires payers of crop loan and insurance income to send information returns to both the income recipients and IRS. Both ASCS and FCIC expect to begin issuing information returns in the near future.

ASCS Information Return Plans

Section 6050J of the Internal Revenue Code requires the Department of Agriculture to issue information returns on liquidated commodity credit loans, beginning with loans liquidated in calendar year 1985. ASCS officials said that they currently would have difficulty issuing information returns for liquidated loans because of their decentralized, manually operated loan program.

However, they told us that they are presently installing a nationwide computer system linking all of the county offices to the ASCS Kansas City Management Office. They said that this new system, which will be operational in 1987, will contain the information necessary for ASCS to easily consolidate loans and issue an information return for each taxpayer. According to the Controller of the Commodity Credit Corporation, once the new system is operational, ASCS will begin issuing information returns on liquidated loans.

FCIC Information Return Plans

Section 6041 of the Internal Revenue Code generally requires insurers to file information returns for crop insurance indemnity payments.¹ Beginning in 1986, according to an FCIC spokesman, FCIC will provide such returns to insurance claimants and IRS. The FCIC Director wrote us that issuing information returns to FCIC insureds will benefit all of the parties involved. He said that besides aiding IRS and taxpayers, information returns will help FCIC to identify claimants who owe it payments under other various policy numbers and names. FCIC can then offset these debts against indemnities due.

Information Returns Should
Increase Compliance

Once taxpayers begin receiving information returns identifying the amount of crop loan and insurance income to report, they should make fewer reporting errors. Furthermore, IRS can use these information returns to identify recipients of crop loans and insurance payments who apparently did not file tax returns or did not properly report the income. IRS' costs for information return matching should be minor compared to the additional taxes that would be assessed.

Information Return Benefits

For certain types of income, such as wages and interest, the law requires the payer to send information returns identifying the recipient and the amount of income received to both the taxpayer and IRS. In some cases

¹Revenue Ruling 80-22 (1980) provides that an information return is not required if a taxpayer capitalizes expenses.

the information return also tells the taxpayer the appropriate IRS form or schedule on which to report the income. In passing 1982 legislation requiring information returns on state and local income tax refunds, the Congress stated that such information returns would remind taxpayers of the proper treatment of refunds and would provide them with helpful information during the tax filing season. Given the large proportion of taxpayers in our sample who responded that they had improperly reported either crop loan or insurance income, we believe that information returns for such income will help taxpayers comply with reporting requirements.

Besides helping taxpayers to report their income properly, information returns can help IRS to detect nonfilers and underreporters. The effectiveness of information returns in detecting unreported income is demonstrated by an IRS study conducted under its Taxpayer Compliance Measurement Program. Examiners audited, without access to information returns, every line item on a sample of over 11,000 tax year 1976 returns. Then, they reviewed these returns again along with all of the information returns that were filed for income paid to the taxpayers under examination. Based on this study, IRS projected that if all 1976 returns had been examined, using associated information returns would have increased the unreported income discovered from \$1.3 billion to \$5.6 billion.

When the matching process is automated, it generally allows IRS to identify nonfilers and underreporters less expensively than the Service could by manually examining tax returns. IRS matches almost all information returns submitted on magnetic media to verify that correct amounts are reported on taxpayers' returns. According to IRS' fiscal year 1985 annual report, the information returns program resulted in notifications to more than 3.6 million taxpayers in 1985 of potential discrepancies between income that they had reported on their tax returns and income that had been reported to the IRS on information returns. In addition, 3.0 million taxpayers received notices of apparent failure to file tax returns. In its July 1984 study entitled A Strategic Review of the Information Returns Program, IRS estimated that for fiscal year 1984 the information return matching program would yield \$12 for each dollar spent.

Information Return Matching Cost

The cost to IRS of incorporating commodity credit loan and crop insurance information returns into its document matching program would be less than the potential revenues that would result. An information

return matching program conducted on our sample cases, for example, would have yielded \$51 for each dollar spent.

To calculate the revenue-to-cost ratio for document matching crop loan and insurance income, we used the additional taxes assessed on the underreporters in our sample and estimated the cost of matching information returns for the entire sample. To develop cost estimates we added: (1) the total number of information returns that would be filed multiplied by IRS' estimated cost to process an information return received on magnetic media, (2) the number of key strokes required to computer input the dollar amounts reported on the commodity credit loan and crop insurance income lines multiplied by IRS' estimated costs per key stroke, and (3) the number of identified underreporter cases that would have required manual screening multiplied by IRS' estimated average cost to work an underreporter case

The results of our calculations are shown in table 2.5.

Table 2.5: Comparison of Information Return Matching Costs and Revenues for Sampled Income

Type of income	Estimated cost	Estimated revenues	Revenue-to-cost ratio
Loan	\$640	\$33,625	53:1
Insurance	369	17,464	47:1
Totals	\$1,009	\$51,089	51:1

Preparation Necessary for IRS to Fully Use Information Returns

Making the most of loan and insurance information returns will require some preparation by IRS. IRS must be able to computer match specific types and income amounts reported on designated information returns against amounts reported on specific lines of taxpayers' returns. However, none of the more than 16 different information return forms that IRS receives from payers of various types of income specifically provides for the reporting of crop insurance income. Furthermore, although a form is available for reporting commodity credit loan income, effective computer matching may be difficult because that form is also used to report other types of abandonment or foreclosure income. Finally, taxpayers might not report the income in the same tax year for which the information return was filed. Accordingly, IRS needs to improve information return forms, filing instructions, and computer programs, and to solve matching problems resulting from the taxpayers' reporting-year option.

Improvements Needed in Forms,
Filing Instructions, and Computer
Programs

Under Section 6041 of the Internal Revenue Code, commercial crop insurers, like FCIC, are required to file information returns on crop insurance income. However, IRS has not issued specific instructions on what form to use in filing returns and does not computer match amounts shown on the information returns received to amounts on the specific crop insurance income line on taxpayer returns. As a result, IRS has been unable to effectively use the returns filed by commercial insurers, and without some changes it may not be able to effectively use information returns that will be filed by FCIC.

To determine whether commercial insurers were reporting crop insurance income, and if so, how, we contacted 11 randomly selected commercial insurers—23 percent of the 48 insurers that had crop year 1985 reinsurance contracts with FCIC. Ten of the 11 (91 percent) said that they have been issuing the information returns to taxpayers and IRS. The amounts reported on these information returns can be significant. For example, based on the available data provided by the commercial insurers, total crop insurance income reported by these insurers for calendar year 1984 ranged from \$150,000 to \$15 million.

Representatives of these 10 firms told us that in the absence of instructions from IRS, they submitted the required information on IRS' Form 1099-MISC (Statement for Recipients of Miscellaneous Income). The 1984 form contained eight numbered blocks for reporting several different types of income. Officials from eight firms said that they put the specific indemnity payment amount in block 7 (nonemployee compensation) of the form, an official from one firm said that the specific payment amount was put in block 3 (prizes and awards), and an official from the remaining firm said that an unnumbered blank space was used.

In general, officials of the commercial insurance firms told us that although none of the IRS information return forms seemed to fit this type of payment, they selected Form 1099-MISC through a process of elimination. For example, one official said that after he reviewed the available forms and instructions, the 1099-MISC and its nonemployee compensation block seemed the most appropriate.

IRS officials told us that they were unaware that crop insurance income was being reported on Form 1099-MISC. They also speculated that the use of that form for that purpose may have led to some confusion and unnecessary work. They explained that IRS compares amounts reported on this form to certain items on the taxpayer's return, first by computer and then manually if the computer match shows sufficient variance,

however, neither match compares the amount shown on the information return form with the amount on the crop insurance line of the Schedule F or Form 4835. They agreed that mismatches due to crop insurance income could result in increased workload and unnecessary follow-up with taxpayers.

IRS may also encounter a similar matching problem with the information returns that it will receive on commodity credit loan income. According to IRS officials, liquidated commodity credit loan income should be reported on IRS Form 1099-A (Acquisition or Abandonment of Secured Property) along with other types of abandonment income. Thus, IRS may have difficulty programming its computers to distinguish which type of property was abandoned. Making this distinction is necessary for effective matching, because taxpayers report different types of abandonment or foreclosure income on different locations of their tax returns. For example, an IRS official said that foreclosure income associated with forfeited real estate that was used as rental property should generally be reported on Schedule E, whereas liquidated commodity credit loan income should be reported on Schedule F or Form 4835.

Thus, to most efficiently and effectively incorporate commodity credit loan and insurance income into its matching program, IRS needs to improve its forms, its filing instructions, and its computer programs.

Procedures Needed to Handle Reporting-Year Option

The taxpayer's option to report the income in either of two years (see chap. 1) is an obstacle to effective computer matching. Once a taxpayer has filed an election statement, he or she is not required to do so again. Therefore, IRS cannot readily determine whether a computer-generated mismatch identifies a potential underreporter or a taxpayer who has elected to report the income in another year.

IRS officials offered two practical suggestions for dealing with this problem:

- IRS could revise Schedule F and Form 4835 to require taxpayers to indicate their elections for loan and insurance income by checking boxes. These elections could then be considered during the computer matching process.
- IRS could use its normal processing procedures for these cases, the information returns would be computer matched against the tax return for the year the information return was received. IRS staff could then manually review the mismatched returns to determine whether a taxpayer

elected to report the income in another year. If the IRS staff still could not determine that the income was reported or that the taxpayer elected to report the income in another year, IRS could request the taxpayer's explanation

Conclusions

Most of the crop loan and insurance recipients in our sample were not properly complying with the requirements for reporting this income. Information returns required under existing law should soon help taxpayers to comply better with the requirements. They should also help IRS to cost effectively detect nonfilers as well as filers who improperly reported income from these sources. To make the most efficient and effective use of these returns, however, IRS needs to improve its forms, its filing instructions, and its computer matching programs.

Recommendations

To help improve compliance in the reporting of commodity credit loan and crop insurance income, we recommend that the Commissioner of Internal Revenue

- clarify instructions and forms concerning commodity credit loan and crop insurance income so that taxpayers and IRS can more efficiently and effectively use information returns, and
- incorporate commodity credit loan and crop insurance income into IRS' document matching program

Agency Comments and Our Evaluation

The Secretary of Agriculture and the Commissioner of Internal Revenue commented on a draft of this report by letters dated May 14, 1986, and May 7, 1986, respectively. (See app. IV and V) The Secretary of Agriculture said that the report was favorably received and considered technically correct by the department agencies cited in the report. The Secretary also noted that the ASCS computer system for accumulating loan forfeiture information will be operational in January 1987, and that ASCS will begin reporting such data for income tax purposes at the end of calendar year 1987. IRS agreed to clarify the forms and instructions for commodity credit loan and crop insurance information returns but did not agree to incorporate the returns into its Information Returns Program (IRP).

Regarding our recommendation on information return forms and instructions, IRS has clarified the tax year 1986 instructions by instructing payers to report crop insurance payments in box 7 of Form

1099-Misc. For tax year 1987, IRS plans to revise the tax return and instructions to clarify the proper way for taxpayers to report commodity credit loan and crop insurance income. IRS is also revising Schedule F and Form 4835 to include boxes for taxpayers to check indicating their optional year reporting elections

IRS disagreed, however, with our recommendation that commodity credit loan and crop insurance income information returns be incorporated into IRP. IRS reasoned that existing statutory rules allowing taxpayers to report commodity credit loan and crop insurance income in either of two years present serious administrative problems for matching because IRP is a single-year matching program. IRS said that it will use these information returns in its examination program instead.

We do not believe that IRS' plan for using the information returns will be as effective in dealing with the problem of unreported income as a matching program would be. IRS' plan to use the returns solely in its examination program should help identify individuals who underreport their income on the returns IRS examines—but IRS does not examine many of the filed returns. Further, since IRS' plan is directed solely at filed returns, it will not result in the identification of nonfilers. A substantial amount of the unreported income we identified was associated with nonfilers.

IRS' planned use of information returns in its examination program will consist of providing examiners screening returns for audit potential, as well as examiners actually auditing the returns, with a listing of the information returns and the income received by the taxpayer whose return is being scrutinized. Because a return must be filed before it can be selected for audit, including information returns only in the examination program will not help IRS to detect nonfilers. Further, we estimate that based on IRS' past experience, about 2 to 3 percent of the individual tax returns containing a Schedule F or Form 4835 will be reviewed under the examination program. Thus, the potential for detecting underreporters of commodity credit loan and crop insurance income will be limited to this small percentage of the returns that are filed.

We concur that the taxpayers' option to report their income in either of two years presents document matching problems. Recognizing this, we include in our report some alternatives IRS might pursue in trying to overcome these problems. (See pp. 24 and 25.) IRS, in responding to our report, did not address the feasibility of those alternatives nor indicate that it would try to identify others. We believe the alternatives for

Chapter 2
Information Returns Should Help Assure
That Taxpayers Properly Report Commodity
Credit Loan and Crop Insurance Income

matching discussed in the report could be viable, low-cost, and effective ways to overcome the problems. Although we did not determine the one-time initial computer programming cost to establish a matching program, we estimated that the cost of operating such a program for our sample cases would have yielded \$51 for each dollar spent. Accordingly, we continue to believe that IRS can overcome the administrative problems and incorporate commodity credit loan and crop insurance income into IRP

Sampling Methodology and Statistical Projections

Our sampling plan was designed to provide statistically valid projections of unreported commodity credit loan and federal crop insurance income and the lost tax revenues associated with the unreported income. However, as explained in more detail below, we could not project some of our sample results to the total universe of liquidated loans or insurance indemnity payments because: (1) IRS follow-up to determine if the taxpayers had actually underreported their income was limited to a portion, rather than all, of the potential underreporter cases we identified, (2) some crop year 1982 liquidated loans and insurance payments were excluded from the sampled universe; and (3) we were not able to obtain all the sample case tax returns that were filed

IRS Assistance

IRS assisted us by corresponding with a portion of the potential underreporters to verify that the questioned loan or insurance income was not reported. IRS sent each of the selected taxpayers a letter proposing an additional tax assessment and explaining that, according to ASCS or FCIC records, the taxpayer had received commodity credit loan or crop insurance income that had not been reported on the tax return line designated for that type of income. IRS asked the taxpayer to explain where and when the income was reported or to agree with IRS' proposed assessment if the income was not reported. Taxpayers who did not respond to the first letter were sent a second letter stating that IRS was giving them 90 days to respond, after which time they would automatically be assessed the additional tax liability. If the responding taxpayer explained that the income was accounted for in some way, IRS accepted the explanation for the purposes of this study and did not attempt to further verify that the income was actually reported.

Given the concern in IRS about the impact that assisting us would have on its resources, we mutually agreed that IRS would limit its initial follow-up effort to a judgmental selection of 84 taxpayers who had filed returns with IRS' Fresno and Ogden Service Centers. IRS told us that it wanted to consider the results of this initial effort before deciding whether to follow up on our entire sample of improper reporters and then whether to review in full all 1982 loans and insurance payments.

Although the initial follow-up effort identified numerous nonfilers and underreporters, IRS determined that the cost of a full review program did not appear justified. The cost would be extensive because the program, for the most part, would have to be done manually. More specifically, ASCS and FCIC would have to compile the liquidated loan and crop insurance payment information, and IRS would have to manually review

each recipient's tax year 1982 and/or 1983 return. Therefore, IRS ceased its follow-up efforts. The limited IRS follow-up, combined with our sampling methods (described below), precluded us from projecting some of the sample results

Commodity Credit Loan Sampling Plan

We used a combination stratified and clustered approach plan to draw samples of crop year 1982 liquidated commodity credit loans totaling \$2.3 billion. Our plan called for projections to the state and national levels and included the following steps.

- First, we summarized, by state, ASCS crop year 1982 microfiche records that showed the dollars of commodity loans that were still outstanding, repaid, or liquidated.
- Second, we removed from the universe 17 states where closed loans totaled less than \$20 million each. The liquidated loans in these 17 states amounted to \$21 million, which was less than 1 percent of the total.
- Third, the two states with the highest value of liquidated loans, Nebraska and Iowa, were selected as the first stratum
- Fourth, as the second stratum, we randomly selected four cluster states from the states remaining in our universe. These four states were California, Kentucky, Montana, and Oklahoma
- Finally, in each of the selected states except California, we randomly selected 4 to 8 counties as secondary clusters. In California, we sampled from the entire state.

Sample Case Selection

For the state of California and the counties in Nebraska, Iowa, Kentucky, Montana, and Oklahoma, we listed all of the crop year 1982 loans liquidated within those locations. We randomly selected at least 30 liquidated loans for each county and 74 loans for California. If a county had less than 30 liquidated loans, we included all of its loans in the sample.

We then contacted the ASCS office that processed each loan and obtained the information required to complete our analysis—taxpayer name and identification number, loan origination and settlement dates, and final loan settlement amount. We also obtained the pertinent information on all other crop year 1982 loans that were liquidated by the sample recipient. We used the nonsample loan information to determine whether the sample recipients fully reported their commodity credit loan income on their tax returns. However, because the nonsample loans were not randomly selected, we applied the recipients' marginal tax rates only to the

unreported sample loans when computing and projecting the lost federal tax revenues associated with the unreported income

Projections and Confidence
Levels

Our sample was designed to produce projections at the 95 percent confidence level of the number and dollar amount of liquidated loans for which the recipients involved did not (1) file their 1982 and/or 1983 tax returns or (2) fully report their income. We also projected the lost tax revenues associated with taxpayers that underreported their income. Without tax returns, however, we could not project the lost tax revenues associated with nonfilers.

Our sampling plan allowed us to project to \$714 million of the \$2.3 billion of crop year 1982 liquidated loans. Accordingly, for that portion of the universe, we estimated that recipients of 3,665 loans amounting to about \$38 million did not file their required tax returns. At the 95 percent confidence level, our estimates ranged from a low of 29 loans¹ totaling \$11 million to a high of 8,106 loans totaling over \$65 million.

IRS' follow-up with a limited number of the potential underreporters precluded us from projecting unreported commodity credit loan income nationally. However, we could project our sample results to the states in which IRS follow-up occurred—California, Nebraska, and Montana.

Before making this projection of underreported income, we reduced the \$332.9 million liquidated loan universe by \$227.1 million (68 percent) to account for commodity credit loan income excluded from our analysis. We excluded from our analysis income received by (1) nonfilers, (2) income recipients whose loans were not liquidated at the time of our sample or whose returns were not available for analysis, and (3) taxpayers who filed a business return. Table I.1 details how the universe was reduced.

¹We used the actual sample results as the lower limit because it was greater than the projected amount.

**Table I.1: Crop Year 1982 Projected
Loan Universe**

Dollars in thousands				
	California	Montana	Nebraska	Total
Actual universe	\$20,605	\$36,338	\$275,950	\$332,893
Less projected				
Nonfilers	(1,695)	(563)	(1,011)	(3,269)
Unliquidated loans at time of sample	(10,014)	(24,484)	(143,061)	(177,559)
Unavailable tax returns	(2,645)	(1,097)	(13,153)	(16,895)
Business return filers	(3,483)	(4,160)	(21,689)	(29,332)
Projected universe	\$2,768	\$6,034	\$97,036	\$105,838

For the universe of remaining loans, we estimated that in these three states the income from 156 commodity credit loans amounting to \$1.9 million was not reported, resulting in \$215,000 of lost federal tax revenues. At the 95 percent confidence level, our estimates ranged from a low of 20 loans, totaling \$159,000 of income² and representing \$34,000 of lost tax revenues, to a high of 361 loans, totaling \$5.0 million of income and \$529,000 of lost tax revenues.

Federal Crop Insurance Payment Sampling Plan

Compensation paid on crop year 1982 federal crop insurance contracts totaled \$459 million. However, because taxpayers have an option regarding the year in which they report the income, we reduced the universe to those crop year 1982 indemnity payments made between January 1, 1982, and December 17, 1982—a total of \$168 million. These taxpayers should have received their compensation payment by December 31, 1982, and thus should have reported the income either on their tax year 1982 or tax year 1983 return—the latest returns on file at the time of our sampling. The remaining \$291 million was paid after December 17, 1982, and may not have been received until 1983, therefore, it could have been reported on tax year 1984 returns, which were not yet filed when we began our review.

We reduced the universe another \$4.8 million by excluding those payments which in our opinion had minimum tax change potential, i.e., those payments that were less than \$1,000. Ultimately, the \$459 million crop year 1982 indemnity payment universe was reduced to \$163.2 million.

²We used the actual sample results as the lower limit because it was greater than the projected amount.

Sample Selection

We used a stratified sampling plan to select 370³ indemnity payments. The sample was chosen from FCIC's automated 1982 payment master file. Before selecting the sample, we stratified the data as shown in table I.2 and excluded the stratum comprising indemnity payments of less than \$1,000 from the sampling frame.

Table I.2: Stratified FCIC Indemnity Payment Universe and Number of Sample Payments Selected

Strata boundaries	Amount (000 omitted)	Percent of total	Number of payments	Percent of total	Number sampled
\$50,000 and more	\$29,822	17.8	362	1.1	89
\$30,000 to \$49,999	19,268	11.5	505	1.5	14
\$10,000 to \$29,999	54,629	32.5	3,322	10.2	84
\$1,000 to \$9,999	59,455	35.4	16,672	51.0	183
Sampled universe	163,174		20,861		370
Under \$1,000	4,824	2.9	11,803	36.1	0
Totals	\$167,998	100.0^a	32,664	100.0^a	370

^aTotals do not add due to rounding

The 370 sample payments were optimally selected in accordance with standard automated selection methods.

Projections and Confidence Levels

As with the commodity credit loan sample, our sample plan was designed to produce projections at the 95 percent confidence level of the number and dollar amount of indemnity payments for which the recipients did not file their 1982 and/or 1983 tax returns.

Our sampling plan allowed us to project to \$163 million of the \$459 million of crop year 1982 crop insurance indemnity payments. Accordingly, for that portion of the universe, we estimated that recipients of 1,588 insurance payments totaling about \$15 million did not file their required tax returns. At the 95 percent confidence level, our estimates ranged from a low of 915 indemnity payments amounting to \$9.1 million to a high of 2,262 indemnity payments totaling over \$20 million.

Because our sample was nationwide, while IRS' follow-up was limited to three states, we could not project federal crop insurance income that was not reported by those who filed returns.

³Six erroneous taxpayer identification numbers reduced the number of payments we actually reviewed to 364.

Schedule F (Farm Income and Expenses)

SCHEDULE F (Form 1040) Department of the Treasury Internal Revenue Service (00)	Farm Income and Expenses Attach to Form 1040, Form 1041, or Form 1065 See Instructions for Schedule F (Form 1040)	OMB No 1545-0074 <div style="font-size: 2em; font-weight: bold;">1983</div> 13																																																																																																																			
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48 Freight trucking																																																																																																																					
49 Conservation expenses																																																																																																																					
50 Land clearing expenses (see instructions for limitations)																																																																																																																					
51 Pension and profit sharing plans																																																																																																																					
52 Employee benefit programs other than line 51																																																																																																																					
53 Depreciation and Section 179 deduction (from Form 4562)																																																																																																																					
54 Other (specify) ▶																																																																																																																					
55 Total deductions (add lines 32c through 54)																																																																																																																					
56 Net farm profit or (loss) (subtract line 55 from line 31). If a profit, enter on Form 1040 line 19 and on Schedule SE Part I line 1. If a loss, go on to line 57. (Fiduciaries and partnerships see the instructions.)		56																																																																																																																			
57 If you have a loss, you must answer this question: Do you have amounts for which you are not at risk in this farm (see instructions)? If Yes, you must attach Form 6198. If No, enter the loss on Form 1040 line 19 and on Schedule SE, Part I line 1.		<input type="checkbox"/> Yes <input type="checkbox"/> No																																																																																																																			
For Paperwork Reduction Act Notice see Form 1040 Instructions		Schedule F (Form 1040) 1983																																																																																																																			

Appendix II
Schedule F (Farm Income and Expenses)

Schedule F (Form 1040) 1983

14

Page 2

PART III — Farm Income—Accrual Method (Do not include sales of livestock held for draft, breeding, sport, or dairy purposes, report these sales on Form 4797 and omit them from "Inventory at beginning of year" column)

a Kind	b Inventory at beginning of year	c Cost of items purchased during year	d Sales during year	e Inventory at end of year
58 Cattle and calves				
59 Sheep				
60 Swine				
61 Poultry				
62 Dairy products				
63 Eggs				
64 Wool				
65 Cotton				
66 Tobacco				
67 Vegetables				
68 Soybeans				
69 Corn				
70 Other grains				
71 Hay and straw				
72 Fruits and nuts				
73 Machine work				
74 Other (specify) ▶				
75 Totals (enter here and in Part IV below)	(Enter on line 84)	(Enter on line 85)	(Enter on line 77)	(Enter on line 76)

PART IV — Summary of Income and Deductions—Accrual Method

76 Inventory of livestock, crops, and products at end of year (line 75 column e)

77 Sales of livestock, crops, and products during year (line 75 column d)

78 Agricultural program payments

a Cash

b Materials and services

79 Commodity credit loans under election (or forfeited)

80 Federal gasoline tax credit

81 State gasoline tax refund

82 Other farm income (specify) ▶

83 Add lines 76 through 82

84 Inventory of livestock, crops, and products at beginning of year (line 75 column b)

85 Cost of livestock and products purchased during year (line 75 column c)

86 Total (add lines 84 and 85)

87 Gross profits (subtract line 86 from line 83)

88 Total deductions from Part II, line 55

89 Net farm profit or (loss) (subtract line 88 from line 87). If a profit, enter on Form 1040, line 19, and on Schedule SE, Part I, line 1. If a loss, go on to line 90. (Fiduciaries and partnerships, see the Instructions.) 89

90 If you have a loss, you must answer this question: Do you have amounts for which you are not at risk in this farm (see Instructions)? Yes No

If Yes, you must attach Form 6198. If No, enter the loss on Form 1040, line 19, and on Schedule SE, Part I, line 1.

86

Form 4835 (Farm Rental Income and Expenses)

Form **4835**

Department of the Treasury
Internal Revenue Service

Name(s) as shown on Form 1040

Farm Rental Income and Expenses

(Crop and Livestock Shares Received by Nonparticipating Landowner (or Sub Lessor))

(Income not subject to self employment tax)

▶ Attach to Form 1040

OMB No 1545-0187

1983
70

Social security number

If you filed Form 943 enter employer identification number here

Purpose of Form — Use this form to report farm rental income based on crops or livestock produced by the tenant if you were the landowner (or sub lessor) and did not materially participate in the operation or management of the farm

Under both the cash and the accrual methods of reporting you

must report livestock or crop share rentals received in the year in which you convert them into money or its equivalent

Landowners (or sub lessors) must not use this form to report cash rent received for pasture, or farmland, if the amount is based on a flat charge. Report this income directly on Schedule E (Form 1040)

PART I — Gross Farm Rental Income — Based on Production

(Include amount converted to cash or the equivalent)

PART II — Deductions — Farm Rental Property

(Exclude personal and living expenses)

PART I — Gross Farm Rental Income — Based on Production		PART II — Deductions — Farm Rental Property	
Kind	Amount	Items	Amount
1 Cattle and calves		25 a Labor hired (see Schedule F instructions)	
2 Sheep		b Jobs credit	
3 Swine		c Subtract line 25b from line 25a	
4 Poultry		26 Repairs maintenance	
5 Dairy products		27 Interest	
6 Eggs		28 Rent of farm pasture	
7 Wool		29 Feed purchased	
8 Cotton		30 Seeds plants purchased	
9 Tobacco		31 Fertilizers lime chemicals	
10 Vegetables		32 Machine hire	
11 Soybeans		33 Supplies purchased	
12 Corn		34 Breeding fees	
13 Other grains		35 Veterinary fees medicine	
14 Hay and straw		36 Gasoline fuel oil	
15 Fruits and nuts		37 Storage warehousing	
16 a Patronage dividends		38 Taxes	
b Less Nonincome items		39 Insurance	
c Net patronage dividends		40 Utilities	
17 Per unit retains		41 Freight trucking	
18 Agricultural program payments		42 Conservation expenses	
a Cash		43 Land clearing expenses (see Schedule F instructions for limitations)	
b Materials and services		44 Pension and profit sharing plans (see Schedule F instructions)	
19 Commodity credit loans under election (or forfeited)		45 Employee benefit programs other than line 44 (see Schedule F instructions)	
20 Federal gasoline tax credit		46 Depreciation and Section 179 deduction (from Form 4562)	
21 State gasoline tax refund		47 Other (specify) ▶	
22 Crop insurance proceeds			
23 Other (specify) ▶			
24 Gross farm rents (add lines 1 through 23)		48 Total deductions (add lines 25c through 47)	

49 Net farm rental profit or (loss) (subtract line 48 from line 24). If a profit, enter here and on Schedule E (Form 1040) Part I, line 24. If a loss, go on to line 50 before you enter the loss here and on Schedule E (Form 1040)

50 If you have a loss, you must answer this question: Do you have amounts for which you are not at risk in this farm (see instructions for Schedule F)?
 If you checked Yes, you must attach Form 6198. If you checked No, enter the loss on Schedule E, Part I, line 24.



Appendix III
Form 4835 (Farm Rental Income
and Expenses)

Form 4835 (1983)

Page 2

General Information

**Paperwork Reduction
Act Notice**

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Note: Tenants must not use this form to report farm income and expenses (Individuals use Schedule F (Form 1040).)

Line-by-Line Instructions

**PART I.—Gross Farm Rental
Income—Based on Production**

Lines 1 through 15

For each kind of livestock and crop, report income you received based on production. Include amounts converted to cash or the equivalent.

Line 16

Patronage dividends are profits from a farming co-op. See Schedule F instructions.

Line 17

Per-unit retains are amounts held for you by a farming co-op. See Schedule F instructions.

Lines 18 through 23

Include agricultural program payments, certain loans, credits and refunds, and other payments.

**PART II.—Deductions—
Farm Rental Property**

Lines 25 through 45

Report expenses listed. Do not include personal and living expenses.

If you report both farm rental income on line 24 of this form and cash rental income from farm property in Schedule E (Form 1040), you do not have to prorate the farm expenses that apply to this farm rental income. Instead, you may report the total farm rental expenses in Part II of this form.

Line 46

Use Form 4562, Depreciation and Amortization, to figure your depreciation deduction. If you are choosing to expense certain recovery property (section 179), also use Form 4562 to figure this deduction. For more information on depreciation and the election to expense certain recovery property, see Schedule F instructions.

Enter on line 46 of Form 4835 the amount of the deduction from Form 4562, Part I.

Line 47

Enter expenses not listed on another line. See Schedule F instructions.

Advance Comments From the Commissioner of Internal Revenue

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

MAY 7 1986

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

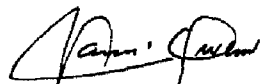
Thank you for the opportunity to review your recent draft report entitled "Tax Administration: Information Returns Should Increase Proper Reporting of Farm Income." Our comments on the report recommendations are as follows:

With respect to the first recommendation, to clarify instructions and forms concerning commodity credit loan and crop insurance income, the instructions for tax year 1986 have been clarified to instruct payors to report crop insurance payments in Box 7 of Form 1099-MISC. For tax year 1987, we plan to revise the tax return and instructions to clarify the proper reporting by taxpayers of commodity credit loan and crop insurance income.

The report's second recommendation was that the Service incorporate commodity credit loan and crop insurance income into the Information Returns Program (IRP). The existing statutory rules that allow taxpayers to report the amounts received under both the commodity credit loan and crop insurance in either of two years presents serious administrative problems for IRP which is a single year matching program. Because of this we do not believe that IRP is the best way of dealing with the issue. However, we will continue to use these information returns in our examination program.

With kind regards,

Sincerely,



James I. Owens
Acting Commissioner

Department of the Treasury Internal Revenue Service

Advance Comments From the Secretary of Agriculture



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

May 14 1986

Mr. J. Dexter Peach
Director
Resources, Community and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach

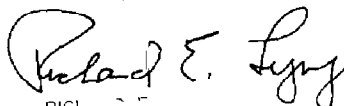
Thank you very much for the opportunity to comment on the GAO Draft Report entitled "Tax Administration Information Returns Should Increase Proper Reporting of Farm Income, GGD-86-"

Our review within the Department centered on the technical content of the report since the proposed recommendations are addressed to the Internal Revenue Service. The Federal Crop Insurance Corporation received an earlier copy of the report and has already responded to you through Under Secretary Naylor's office.

In general, the report was favorably received and considered technically correct by those department agencies cited in your report.

In conclusion, we are pleased to advise you that the Agricultural Stabilization and Conservation Service computer system for accumulating loan forfeiture information will be operational in January, 1987, and shall begin reporting such data for income tax purposes at the end of calendar year 1987.

Sincerely,


RICHARD E. LYNG
SECRETARY

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