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OVERSIGHT OF GOVERNMENT TAX POLICY IN FARM COUNTRY

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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OVERSIGHT OF GOVERNMENT TAX POLICY IN FARM COUNTRY

TUESDAY, JULY 24, 2007

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Lincoln, Stabenow, Salazar, Grassley, and Roberts.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

President Eisenhower once said, "Farming looks mighty easy when your plow is a pencil and you're 1,000 miles away from the cornfield."

President Eisenhower was responding to critics of his program to provide price supports for struggling farmers. Having grown up in Kansas farm country, Eisenhower appreciated the vital and difficult work that farmers do to keep food on America's table.

Today's hearing will look at government tax policy in farm country. Agriculture is vital to my home State's economy and heritage. It is a financial engine that drives Montana's economy, and that is why I am dedicated to ensuring that our farm policies and tax system work for our farmers and for our ranchers.

We do not have farm programs to make farmers rich, that is for sure. We have farm programs to provide a safety net when disaster strikes. Whether it is spring frost, a mid-summer hail storm, or the timely rain that never arrives, all farmers suffer disasters. In agriculture it is not a matter of if, but when.

Earlier this year, Congress passed another ad hoc disaster assistance package, but for some farmers it was too little, too late. Producers still did not have any money from disasters 2 years ago. For some producers who had a disaster in the spring of 2005, payment may not come until early 2008. What type of a safety net kicks in nearly 3 years after a disaster?

Today we will hear testimony about the importance of providing permanent agriculture disaster relief. Last year in the Pensions Protection Act, I was proud to include an enhanced deduction for charitable contributions for conservation purposes.

Under that provision, farmers and ranchers can deduct up to 100 percent of their adjusted gross income for donations of conservation

easements. This year, I introduced legislation to make this enhanced deduction permanent.

This year I also co-sponsored the Endangered Species Act of 2007, along with Senators Crapo, Lincoln, Grassley, and other members of this committee. This bill would create new tax credits and deductions for taxpayers who take measures to aid in the recovery of species that are listed as either threatened or endangered under the Endangered Species Act.

Conservation is important, and these bills will help farmers and ranchers to protect America's land and wildlife. That is why we will also look at other popular conservation programs today, including the Conservation Reserve Program, Grassland Reserve Program, and Wetlands Reserve Program.

Through the Conservation Reserve Program, otherwise known as CRP, farmers can receive help creating long-term resource-conserving habitats on eligible farmland. Questions have arisen about the proper tax treatment of CR payments, so today we will also hear testimony about this important program.

And we will also hear about Social Security payroll tax exemptions for certain visas. Currently, holders of several types of visas can work without paying any Social Security payroll tax. Additionally, the employers of these workers do not have to pay the employer's share of the Social Security payroll tax. The visa holders involved include temporary agricultural workers, foreign students, au pairs, and cultural exchange visitors.

One of the fundamental principles of Social Security is that all workers contribute throughout their careers. Over the years, Social Security coverage has expanded to include agriculture workers, self-employed individuals, and clergy. Social Security is stronger when more workers contribute. Why should these particular types of workers be exempted?

I am also concerned that some foreign workers in these visa categories may have an unfair advantage getting jobs. I want to better understand if these exemptions are still necessary, and I want to explore whether the current policy makes sense.

Sometimes government looks like it is more than 1,000 miles away from the cornfield, and sometimes government policy looks as much like common sense as a pencil looks like a plow. Today we will dig into the facts and try to figure out what the best policy should be.

I would now like to introduce the panel. First, to my left we have Tom Buis, president of the National Farmers Union; next, Terry Fankhauser of the National Cattlemen's Beef Association. Thank you, Mr. Fankhauser, for being here. Next, we have Alison Siskin from the Congressional Research Service; then Lisa Shames from the Government Accountability Office; Glen Keppy from the Department of Agriculture, Farm Service Agency; and finally, John Johnson from the Department of Agriculture, Farm Service Agency. He is not here to deliver a statement, but is here to answer questions. Thanks very much.

All right. I will begin with you, Mr. Buis.

STATEMENT OF TOM BUIS, PRESIDENT, NATIONAL FARMERS UNION, WASHINGTON, DC

Mr. BUIS. Thank you, Mr. Chairman. I commend you for your outstanding efforts on addressing tax issues in rural America. I also commend you for using that President Eisenhower quote, because in my experience the real answers to the challenges we face in rural America lie with the people who work there, live there, and raise their families there.

For that reason, this past year we conducted over 15 farm bill listening sessions around the country. By and large, the farmers and ranchers were pleased with the safety net of the 2002 farm bill, except for disaster. The lack of a permanent disaster program has affected producers all over the country numerous times, and some areas repeatedly for several years, including many areas in the plains States and in the mountain States.

We felt all along that, if we could make one significant improvement in this next farm bill, it would be to include a permanent disaster program. Congress has approved, since 1998, 23 ad hoc disaster bills, totaling $47 billion. But they do not occur just by magic, as you know, because you have been an outstanding supporter in providing that assistance.

It takes a strong enough political will in Congress before the assistance is passed. Oftentimes, producers are in a smaller area where they suffered disaster, several counties or maybe one State, but overall there is not the political support to pass an ad hoc disaster program, as we have experienced over the past 3 years in how difficult it was to get losses covered for the 2005 crop year, the 2006 crop year, and the 2007 crop year, which started off with numerous weather-related disasters occurring, from blizzards to floods. We are in a drought in many areas of the country right now.

In fact, in 2005, 80 percent of the counties nationwide were declared a Federal disaster area. In 2006, over 60 percent. As I mentioned, with the blizzards, the floods, the droughts that are ongoing this year, one way or another we are going to have to address disaster.

To us, our highest priority is, let us set up a permanent program. Let us set up a permanent program so we do not have to wait for the assistance once it is forthcoming from Congress.

As you mentioned, in 2005 a producer who lost their crop may be lucky to get any assistance until 2008, because, every time, the Department of Agriculture has to go back and write new rules. If we had a permanent program in place, once the assistance is available it could be delivered in a timely manner.

The second thing, and it is often mentioned, well, you have risk management programs. Why is that not sufficient? Well, I think it has to be put into perspective. Risk management programs only protect a part of your risk.

I think the average amount of crop insurance purchased is a 65-percent level, so when a disaster occurs that means a farmer or rancher has to take a 35-percent out-of-pocket loss before they get assistance.

Now, some would say, well, that is part of the risk of farming. But when you consider it is an industry where your average rate of return is 2.5 percent, that 35 percent creates a pretty big finan-

cial hole that, if you get in an area where you have 3, 4, 5 years of drought, it is almost impossible to get out of.

So we think number one would be to give more certainty to producers, number two, deliver it in a timely manner, and number three, clean up any abuses or fraud. When you are trying to get enough political support to get a package passed, sometimes things get in there that later you wish probably had not. I think a permanent program addresses that.

The House farm bill, which has passed the House Agriculture Committee and is going to be on the floor this week, does contain authorization for a permanent disaster program, but it does not contain any funding. And one of the problems with the funding, as you are well aware, is we are trying to write a farm bill with a budget baseline that is significantly less than what we had 5 years ago in 2002.

So, there are just not available resources out of existing programs to pay for it. We would urge your support in helping America's farmers and ranchers create a permanent program. Give them a helping hand, not a hand-out.

The CHAIRMAN. Thank you very much, Mr. Buis.

I neglected to say that all of your statements would automatically be in the record, and I would encourage each of you to speak about 5 minutes.

[The prepared statement of Mr. Buis appears in the appendix.]

The CHAIRMAN. All right. Mr. Fankhauser, welcome.

Mr. FANKHAUSER. Thank you.

The CHAIRMAN. You are up next.

STATEMENT OF TERRANCE R. FANKHAUSER, EXECUTIVE COMMITTEE MEMBER, NATIONAL CATTLEMEN'S BEEF ASSOCIATION; AND VICE PRESIDENT, COLORADO CATTLEMEN'S ASSOCIATION, ARVADA, CO

Mr. FANKHAUSER. Thank you. Good morning. My name is Terry Fankhauser. I am the executive vice president of the Colorado Cattlemen's Association and a member of the executive committee for the National Cattlemen's Beef Association.

Thank you, Chairman Baucus and Ranking Member Grassley, for this opportunity to testify on the importance of our Nation's grasslands and the need for permanent disaster programs in our country.

America's ranch lands have long played a role in supporting the Nation's scenic beauty, wildlife, habitat, and economy. They also support, as we all know, many cattle grazing operations. They preserve water quality and quantity, and contribute significantly to our Nation's food supply.

It is no surprise that NCBA is a supporter of working lands, as is the Colorado Cattlemen's Association. We also support voluntary conservation programs, which allow producers to meet conservation goals, as well as the growing regulations that they face.

Many of our members have been on the land for generations and want their children and grandchildren to have that opportunity as well. Our ranches and grasslands keep open spaces open. Our producers, their families, and communities keep rural America rural. Everyone in the cattle industry is striving to keep on-farm jobs on

the farm. As you know, that is one of the biggest issues we face in this industry.

We need to keep our grasslands and ranch lands intact. We need tools like the Grasslands Reserve Program and the Farm and Ranch Protection Program to help producers on the land and in this business. NCBA and CCA support continued funding for GRP to help conserve our Nation's working grasslands in the 2007 farm bill.

NCBA is also seeking a number of programmatic changes to make GRP more landowner-friendly. We continue to look forward to working with the Agriculture Committee on those, such as allowing private land trusts to hold easements, using those private land trust templates for easements, and allowing transfer of those easements to other private land trusts.

Regarding another important conservation issue, in 2006 Congress changed the tax incentive for voluntary easement donations—donations for private land owners that require development rights to protect significant wildlife, scenic, and historic resources. That change enabled family farmers, ranchers, and other moderate-income landowners to get a significant tax credit for such donations, which was not possible under previous law.

Thank you, Chairman Baucus and Ranking Member Grassley, for introducing legislation to make this 2006 incentive a permanent part of the tax law. We look forward to seeing S. 469 moved through the Finance Committee and be enacted permanently in law. It is a significant tool for Colorado ranchers.

Shifting focus a bit, one issue that constantly lingers that is a concern to all agriculture producers is the devastating blows that Mother Nature can deal in the form of unexpected weather conditions such as hurricane, wildfire, tornado, blizzards, floods, and even prolonged drought.

Colorado has experienced two of those, ironically, at opposite parallels in the last 8 years. Due to the nature of agricultural production, farmers and ranchers are uniquely vulnerable to these natural disasters, and over the years livestock producers have suffered tremendous losses as a result of that.

Before getting into the issue of disaster assistance programs, though, I would like to thank those members of the committee who played an instrumental role in bringing about an alteration to section 1033(e), which provides for deferment of proceeds due to weather-related sales of livestock.

Back to disaster assistance programs. Over the past several years, Congress has moved to pass disaster assistance on an ad hoc basis in an effort to help those impacted by these events. It has become abundantly clear to us, though, across the West, across the United States that these touch-and-go systems for addressing disaster are no longer an effective or viable means of providing timely aid to those in need, and I will emphasize the word "timely."

Member-driven policy within CCA supports pursuing adequate funding for livestock assistance programs to aid producers adversely impacted by these conditions, and calls for the Secretary of Agriculture to be allowed the authority to quickly obtain funding sufficient to swiftly implement livestock disaster assistance.

With this in mind, cattle producers would urge the construction of permanent disaster assistance programs that include three particular FSA programs: the Livestock Indemnity, Livestock Compensation, and Emergency Conservation Programs.

Cattle producers firmly believe that, in implementing any disaster assistance program, the distribution of those funds should be directed to only—and I emphasize only—those producers directly impacted by disaster conditions.

Additional eligibility criteria for all livestock assistance and compensation programs should be based on livestock and/or forage production losses, and these losses should be the foundation of funding distribution.

Thank you again for allowing me this opportunity to share our views on these important issues.

The CHAIRMAN. Thank you, Mr. Fankhauser, very much.

[The prepared statement of Mr. Fankhauser appears in the appendix.]

The CHAIRMAN. Dr. Siskin?

STATEMENT OF ALISON SISKIN, Ph.D., SPECIALIST IN IMMIGRATION POLICY, DOMESTIC SOCIAL POLICY DIVISION, CONGRESSIONAL RESEARCH SERVICE, WASHINGTON, DC

Dr. SISKIN. Thank you, Chairman Baucus, Ranking Member Grassley, and distinguished members of the committee, for the invitation to appear before you today to speak about the visa categories which are exempt from the Social Security component of the FICA tax. I am Alison Siskin, a specialist in immigration policy at the Congressional Research Service.

There are six non-immigrant visa categories which, by statute, are not covered by Social Security. They are: the H–2A, temporary agricultural workers; F–1, academic students; M–1, vocational students; J–1, exchange visitors; Q–1, cultural exchange visitors; and Q–2, Irish peace process cultural exchange visitors.

The first category which I will discuss is the H–2A temporary agricultural visa category. The H–2A program allows for the admission of foreign workers to perform seasonal agricultural work. Employers must pay their H–2A workers the same wages as U.S. workers and must provide workers with housing, transportation, and other benefits.

In fiscal year 2006, approximately 37,000 H–2A visas were issued. The H–2A program, however, remains small relative to the total hired farm employment, which was about 1.1 million in fiscal year 2005.

Under current law, work performed by foreign agricultural workers is not subject to FICA taxation. Prior to 1956, the FICA tax exclusion for foreign agricultural workers applied only to services performed by workers from the Bahamas, Jamaica, and other British West Indies and to contract workers from Mexico hired in accordance with the Agricultural Act of 1949.

The FICA tax exemption for the Mexican workers was included as part of the Agricultural Act amendments of 1951. The Senate report for this bill indicated that Congress exempted these employees because, due to the relatively short period of time that the workers

would work for a single employer, very few of them would be subject to the Social Security contributions.

Interestingly, the minority view against the exemption expressed concern that the exclusion of the Mexican workers from the insurance program could result in the hiring of such workers in preference to Americans, since their employers would have a competitive advantage of not paying Social Security contributions.

In addition, they noted that since its enactment the Social Security insurance program had covered individuals in specific types of jobs without regard to nationality, and the social insurance systems in a number of foreign countries did not discriminate against U.S. nationals performing services in covered employment.

The Social Security amendments of 1956 extended the FICA tax exclusion of agricultural workers to foreign workers admitted to perform agricultural labor from any foreign country. According to the Senate report for the 1956 amendments, the exemption was extended because the committee had previously recognized the undesirability of covering foreign agricultural workers who only served temporarily in the United States.

I would now like to turn to the FICA exemption for foreign students and exchange visitor visas. Of the three visa categories used by foreign students, the F and M visa categories are solely for foreign students, while the J visa category is more varied and includes aliens in diverse cultural exchange programs such as foreign medical graduates, Fulbright scholars, international visitors, and au pairs.

The Q visa categories are for specific types of cultural exchanges, which include training and employment. In fiscal year 2006, the Department of State issued approximately 310,000 J visas, 274,000 F visas, 7,000 M visas, and 16,000 Q visas. The Social Security Act specifically excludes the work of F, J, and Q visa holders from covered employment.

The Mutual Educational and Cultural Exchange Act of 1961 provided the FICA exemption for F and J visa holders. The conference report for the Act stated that the exemption for foreign students and exchange visitors was enacted because these aliens are temporarily in the country and scarcely have any expectation of realizing a benefit.

Notably, since 1950, the work of U.S. citizens and permanent resident alien students employed by their schools has been exempt from FICA taxes. The FICA tax exemption for Q visa holders was part of the Social Security Independence and Program Improvements Act of 1994.

According to congressional records, the exemption was added so that Q visa holders would be treated the same as J visa holders. When the Q–2 visa category was created in 1998, it was covered under the existing provisions exempting Q visa holders. Congressional records were silent on whether the Q–2 visa holder exemption was intentional.

I would like to conclude by discussing an estimate from the actuaries at the Social Security Administration, SSA, on the financial effects to the Social Security trust fund of covering the earnings of the aliens in these six visa categories.

The actuaries found that extending Social Security coverage to aliens in the currently exempt visa categories would, in 2008, increase the number of covered workers by approximately 174,000, primarily J–1 visa holders, and increase payroll tax revenue by approximately $521 million.

Over a 10-year period, SSA estimates that removing the FICA exemption for these visa categories would increase Social Security payroll tax revenues by $6.9 billion, as few of these workers would qualify for Social Security benefits.

Thank you again for the opportunity to speak here today, and I look forward to your questions.

The CHAIRMAN. Thank you very much, Dr. Siskin.

[The prepared statement of Dr. Siskin appears in the appendix.]

The CHAIRMAN. Ms. Shames?

STATEMENT OF LISA SHAMES, DIRECTOR, NATURAL RESOURCES AND ENVIRONMENT, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Ms. SHAMES. Yes. Thank you. Chairman Baucus, Ranking Member Grassley, and members of the committee, I am pleased to be here today to discuss the U.S. Department of Agriculture's actions to prevent improper payments to estates and deceased individuals.

Farmers receive about $20 billion annually in farm program payments. The magnitude of these payments, along with our work showing ineffective enforcement, is why enhanced oversight is needed.

I would like to discuss the two key findings of our just-released reports. First, we found that USDA does not systematically determine whether an estate is eligible to receive farm program payments. As a result, USDA does not know if these estates are kept open for the primary purpose of receiving such payments.

Second, we found that USDA paid $1.1 billion to over 172,000 deceased individuals from 1999 to 2005, the period our review covers. USDA cannot be assured that these payments are proper because it lacks essential management controls.

First, regarding payments to estates, USDA's Farm Service Agency paid over $200 million to nearly 42,000 estates. There are many legitimate reasons for keeping an estate open, such as to distribute assets.

According to regulations, after 2 years FSA is to determine annually that an estate is still eligible to receive payments, specifically that the heir or personal representative of the estate is actively engaged in farming, and that the estate is not being kept open for the primary purpose of receiving payments. Farming operations are to certify that the information they provide is accurate.

However, we found that FSA does not systematically determine whether these estates are eligible. Over three-fourths of the estates in our sample did not receive all of the required annual determinations. In fact, the longer an estate was kept open, the less likely it was to receive the required determinations.

Even when FSA conducted some or all of the required determinations, we found shortcomings. FSA approved payments with limited information. In numerous cases we found only a statement that the

estate was remaining open upon the advice of lawyers and accountants, with no further explanation.

Also, FSA approved payments to groups of estates without an individual review. In one case, minutes of an FSA County Committee meeting indicated approval of a group of 107 estates. FSA officials told us the lack of sufficient personnel and time, as well as competing priorities, explains why many determinations were either not done, or not done thoroughly.

Next, regarding payments to deceased individuals, FSA paid $1.1 billion in farm program payments to over 172,000 deceased individuals. Forty percent went to individuals who had been dead for 3 or more years, 19 percent had been dead for more than 7 years.

For example, FSA provided more than $400,000 to an individual who died in 1995. The shareholder of the farming operation with signature authority failed to notify FSA of the individual's death, as required as recently as 2004. FSA recognized the potential improper payments in 2006 when the deceased individual's children contacted the office to obtain signature authority for themselves.

The complex nature of some farming operations can increase the potential for improper payments. Payments to deceased individuals through entities, mostly corporations and general partnerships, accounted for 58 percent of the $1.1 billion paid to deceased individuals. In contrast, payments to all farm program recipients through entities accounted for 27 percent. FSA lacks essential management controls, such as a computer matching of its databases with the Social Security Administration's Death Master File to verify that a farming operation has failed to report the death of a member.

USDA agreed with, and has already begun to implement, our recommendations. For example, USDA has directed its field offices to review its open estates and has taken steps to begin to access the Death Master File.

In conclusion, over the 7-year period covered in our review, USDA paid nearly $130 billion in farm program payments. In light of this Nation's current deficit and growing long-term fiscal challenge, it is critical that farm program payments are made properly, otherwise we have little assurance that these payments go to those who are truly engaged in farming.

Mr. Chairman, this concludes my prepared statement, and I would be pleased to answer any questions that you or other members of the committee may have.

The CHAIRMAN. Thank you very much, Ms. Shames.

[The prepared statement of Ms. Shames appears in the appendix.]

The CHAIRMAN. Mr. Keppy?

STATEMENT OF GLEN KEPPY, ASSOCIATE ADMINISTRATOR, FARM PROGRAMS, DEPARTMENT OF AGRICULTURE, FARM SERVICE AGENCY, WASHINGTON, DC; ACCOMPANIED BY JOHN JOHNSON, DEPUTY ADMINISTRATOR, FARM PROGRAMS, DEPARTMENT OF AGRICULTURE, FARM SERVICE AGENCY, WASHINGTON, DC

Mr. KEPPY. Mr. Chairman, Ranking Member Grassley, and committee, thank you for the opportunity to appear before you to review the Department of Agriculture's response to the GAO audit.

We will provide a brief overview of our county office review procedure, an update on actions taken by FSA, and additional actions that are in the process of being implemented.

The FSA has responsibility for the administration of multiple commodity and conservation programs under which payments are issued to producers. Some of these programs have limitations on the amount of payments which may be received by a person.

A "person," for payment limitation purposes, may be an individual or an entity such as a corporation, or the combination of individuals and entities. For example, a corporation and a major stockholder can be combined as one person for payment limitation purposes.

Also, under these programs, payments may be issued well after the payment has been earned. For an example, counter-cyclical payments under the Direct and Counter-cyclical Payment (DCP) program may be issued up to 2 years and 3 months after the producer has enrolled.

During the course of farming operation, participants die and estates are formed. Often, an individual may have met all eligibility requirements to receive a program payment, but dies before the payment is actually issued. In such instances the payment must be issued to the taxpayer identification number of the individual who actually earned the payment.

Estates are legal entities and may receive program payments if they meet eligibility requirements. FSA has a longstanding policy of requiring a review of estates that request program benefits which are still open 2 years from the date in which the producer died.

The purpose of this policy is to make sure that the estate is still in existence and not being kept open for the sole purpose of receiving program payments which could otherwise not be received.

GAO recently completed the review of program payments during the years 1999 through 2005. GAO's objectives were to determine the extent to which individual decedents' estates received farm program benefits beyond the 2-year allotment of the payment eligibility rule and the extent that these estates, as members of entities, received farm program benefits beyond the 2 years allowed. Also reviewed was the extent to which program payments were issued to deceased individuals.

In the audit, GAO questioned the level of documentation used to support the determination made by county committees that an estate was not kept open for the purpose of obtaining program payments. Some county committees did more comprehensive reviews than others. In addition, FSA did not complete the reviews of active estates as diligently as required by policy.

FSA issued over $130 billion in farm program payments and benefits for the years 1999 through 2005. GAO found that, during this period, FSA issued a significant number of farm program payments to deceased individuals.

I want to be clear about the fact that there are legitimate circumstances under which it is legal for payments to be issued to deceased individuals. In fact, in some cases we are required to issue such payments.

It is also important to note that GAO concluded that 58 percent of the questioned farm program payments were not made to deceased individuals at all or to their estates, but rather to entities in which they held an interest when they were alive. In other words, more than half of the payments went to entities which we had no reason to believe were ineligible.

GAO noted that the complex nature of some types of farming entities makes it more difficult for FSA to determine if the producer information is accurate. GAO also pointed out that FSA is reliant on farmer operations to self-certify that the information provided is accurate and that the operation will timely inform FSA of any operational change.

FSA is working on a system that will change this reliance on self-certification. We plan to obtain information from the Social Security Administration database.

In response to the GAO report, FSA implemented several courses of action that followed the guidance recommended by the report. As I referenced a moment ago, FSA directives issued to the field offices in May of 2007 required the review of all active estates in existence for more than 2 years that are not receiving 2007 payments.

These reviews will be complete by August 31. All State FSA offices must have reported this information to the national office by September 15. These reviews will be completed prior to the issuance of final 2007 DCP and conservation CRP payments on or about October 1.

I mentioned our efforts to coordinate with the Social Security Administration. FSA will use a data match process similar to the process that GAO used in the audit. Data from the Social Security Administration's Death Master File will be compared with FSA producer payment history files and the Service Center Information Management System.

This will provide a means of identifying decreased producers before the issuance of payments. FSA will not be in total reliance of the information being provided from program participants for certain changes of entities due to death.

Mr. Chairman, while GAO has identified weaknesses, FSA has taken steps to remedy these weaknesses and to put in place additional safeguards against improper payments. As mentioned, estates and legitimate entities may be determined eligible to receive program payments.

FSA issued directives for a thorough review of agency records for the completion of the required reviews of estates for the program payment eligibility. Steps have been taken with the agency information technology personnel for the linkage of information from the Social Security Administration Death Master File with the agency producer file to identify deceased individuals and to determine the issuance of program payments, as appropriate.

We are committed to ensure that payments are accurately calculated and properly issued. We appreciate the interests of GAO and this committee in holding us accountable for the payments as we administer them.

Mr. Chairman, thank you for the opportunity to provide this testimony. I would be happy to respond to questions of the committee members at that time.

The CHAIRMAN. Thank you, Mr. Keppy, very, very much.

[The prepared statement of Mr. Keppy appears in the appendix.]

The CHAIRMAN. I would now like to turn to Senator Grassley, the senior ranking member of the committee.

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Mr. Chairman and members of the committee, I have two other obligations this morning—that is why I was late—one with Judiciary and one with Governmental Affairs.

I want to make clear, first of all, for everybody, and I thank Chairman Baucus for holding this hearing, that this hearing is not about threatening Federal farm payments or tearing apart the farm safety net. We want people who receive payments legitimately to continue to receive those payments.

As a farmer and an Iowan, I recognize the importance of the family farm and know firsthand the challenges that these family farmers face. It is very important that we provide an adequate safety net to protect family farmers in order to guarantee the food supply for our Nation, and one that much of the world depends on.

What this hearing is about is keeping people from collecting improper payments. All of this may sound familiar to some of us, because this committee held a hearing June 16, 2004. The title of that hearing was "Strengthening Regulations and Oversight to Better Ensure Agriculture Financing Integrity." In that hearing, we heard GAO say, "Individuals may circumvent the farm payment limitations because of weaknesses in FSA's regulations."

The concern was that large farming operators were able to circumvent payment limitations by using means such as channeling payments to affiliated farm operations. Despite the optimism of that 2004 hearing, better agricultural financing integrity has clearly not occurred.

In fact, you could argue that things have gotten worse. Now we find that deceased individuals are improperly receiving farm payments. It would be more accurate to say that individuals who are still alive are making improper use of payments and that it seems questionable if anything is being done to stop them.

Underneath the novelty of the deceased benefitting from government programs at the expense of the living, we find the same basic problem in that large organizations are able to circumvent payment limitations and take more than their fair share. Slick accountants are benefitting at the expense of the family farmer whom these payments are supposed to help.

I said before that this hearing is not about threatening farm payments, but to ensure that farm programs actually help family farmers. It has been suggested that any amounts that were overpaid are not significant, in that overpayments are a very small share of the total amount of farm payments that have been paid out.

This sort of thinking is absolutely inexcusable. First, the Government Accountability Office testimony seems to indicate that we do not really know the amount of improper payments that have been

made. Additionally, even if the improper payments do amount to half of one percent of farm subsidies paid between 1999 and 2005, that would amount to $650 million. Anyone who could argue that this is not an incredibly vast sum of money has been in Washington too long.

Despite these problems with farm payments, we are now in a strong position to take substantive action. The Finance Committee currently shares eight members with the Agriculture Committee.

This overlap of members gives us the opportunity, as the new farm bill is crafted, to use the expertise of this committee to solve existing tax problems and prevent new problems before they result in a Government Accountability Office report 10 years from now.

As we work on these problems, we must not lose sight of the family farmers who are intended to benefit from farm payments. Farm payments are neither corporate welfare nor subsidies for creative accountants, but should go to the people who actually work the land and not work the tax code.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Mr. Buis, I think a lot of us here want permanent agricultural disaster assistance. The question is just how, in what form, how much, and how should it be paid, because the current situation is just intolerable. I mean, farmers and ranchers who suffer disasters have to beg Congress. They are not sure when Congress is going to act, whether Congress is going to act.

Bankers do not know when Congress is going to act. They do not know what credit to give to farmers who want to go to farm and seed, and so forth. It is really a very bad situation. Even when Congress does finally pass agricultural disaster assistance, it may just cover 1 year and not the years when there is actually disaster.

So could you help this committee a little bit by telling us what the agricultural disaster assistance program was prior to 1996? Because I understand in 1996, Congress repealed the program. Frankly, it would be helpful to know what the program was prior to 1996, the degree to which it worked, whether that can give us any guidance.

The next question is going to be, how do you propose we fund it, and what should the level be? Some are suggesting we take the agricultural tariffs and put them into an agricultural disaster trust fund and use the interest off of that to pay for agricultural disaster. Maybe you have to add a little principal first. I do not know. I think only about $1 billion a year goes in.

But your thoughts. Number one, can you give us any guidance pre-1996, what helped, what did not help in terms of what we should be doing here now; and second, amounts and how it is funded, how you think a good permanent agricultural disaster program might work?

Mr. BUIS. Well, early on we had a Federal disaster program that kicked in, and it was very similar to what we currently do in ad hoc assistance. It was based on a percentage of the loss to help make up for shallow losses.

Over the years, as you know, Congress has stepped in to try to help improve the risk management programs, and there have been

significant improvements in it without a doubt, but it still leaves that gaping hole between what is covered and a farmer's expenses.

So I think our preference would be that you merge the two together. You do not have to make them competing programs, because the risk management programs are beneficial.

The CHAIRMAN. So we are talking here about the so-called shallow loss. Is that correct?

Mr. BUIS. What they call the shallow loss.

The CHAIRMAN. For those who may not know, why don't you explain "shallow loss"?

Mr. BUIS. Sure. Well, the shallow losses are the amount that is not covered by risk management. I think the risk management level of protection nationwide is 65 percent. That means that the farmer is risking 35 percent every year that is not covered.

Most of the disaster programs, again, have been based on the old Federal formula of helping to address that shallow loss, but it does not make anyone whole. I mean, I think that is another thing that needs to be pointed out, Mr. Chairman. This is not going to make it profitable, it is just going to allow them to continue on.

As far as how we fund it, we are as open as anyone on how we can be creative. There was a lot of discussion about shifting money out of the current safety net in the farm bill to pay for it, but we are writing a safety net with almost 60 percent less budget authority than we had in 2002 for the commodity title, so that is really not fair. It is probably politically impossible to do. So, the tariff idea makes a lot of sense.

As far as the level, if you just averaged the amount that Congress has provided in ad hoc assistance over the last several years, I think you can probably even bring it down. But I would say in the neighborhood of $1 billion to $1.5 billion annually, given the fact that some years you are not going to have enough and in other years it may be too much because we cannot control or predict the weather. But that certainty is just so key. We know we are going to pay, whether we pay 3 years after Congress steps in and only covers one out of the three disasters.

But eventually the political support to do something within Congress gets there. Sometimes it is quicker. In 2004 we were getting nowhere on disaster aid, and we had three hurricanes in a month in the State of Florida, which happened to be a key political battleground State. And guess what? Disaster assistance suddenly appeared. So that does not help that farmer out there. He has to sit there and think, oh, gosh, I hope everyone has a disaster.

The CHAIRMAN. That is right. That is a very good point. Sometimes a lot of farmers in my neck of the woods think, gee, nobody cares about us. Nobody knows when we have a drought. You can easily see a hurricane or a tornado. That is on the news and gets everybody all excited.

But a drought is kind of a silent, stealth killer. You cannot quite see it as graphically, dramatically, but it is just as much of a disaster. Sometimes we feel, in our neck of the woods, we have to wait until there is some big hurricane before we can get anything and piggy-back on agricultural disaster assistance.

Mr. BUIS. If I could add one more thing. This has been part of this debate, and it was part of our trouble in getting this last dis-

aster program. There are some people out there—public officials, USDA officials, administration officials—saying farmers are doing well, farm income is up. That is true. But farmers do not farm in the aggregate and weather does not occur in the aggregate. Just because I have a good crop on my farm in Indiana, it does not mean that helps anyone in Montana.

The CHAIRMAN. It is the old tyranny of the averages.

Mr. BUIS. Right.

The CHAIRMAN. Thank you very much.

Senator Grassley?

Senator GRASSLEY. I want to be transparent with my colleagues that Mr. Keppy is a friend of mine because of farming background, and also because of our politics. I am not going to ask you any questions, Glen.

I am sending a letter to the Secretary that involves some of these issues, so those will probably be my questions on what the Department of Agriculture is going to do about this. I know you have testified to some of the things that they did.

I am going to direct my first question to Lisa Shames. In your statement and report, you cite a number of weaknesses in the U.S. Department of Agriculture's procedures and practices to conduct reviews of estates' eligibility to receive farm program payments.

USDA has said that its field offices were busy with many other responsibilities and did not have resources to conduct reviews as required. In your view, what does USDA need to do to remedy the problem?

Ms. SHAMES. We made several recommendations, Senator Grassley. The first was for—and I should add, as I noted in my short statement, USDA has already begun to act on our recommendations. The first was to review all of the estates that have been open for more than 2 years. USDA has sent out such a directive, and Mr. Keppy has laid out the time frame for you.

We also recommended that USDA take advantage of and put in place certain management controls. One is what we used in our own review, and that was to match up USDA's databases with SSA's Death Master File. That provided us a cross-check in terms of who was receiving the farm program payments.

Our last, and third recommendation, was that with further examination, if USDA were to find improper payments, that it go ahead and recover them.

Senator GRASSLEY. All right.

Also to you, in 2004 your agency documented widespread abuse related to the requirements that recipients of farm program payments be actively engaged in farming. GAO found that the abuse resulted from the lack of any measurable standard to determine whether payments are being made to actual working farmers or to participants in sham partnerships designed to avoid payment limitations.

GAO recommended, among other things, that USDA develop and enforce measurable requirements defining a significant contribution of active personal management. Please tell us, with the delivery of today's report, did the concerns that GAO identified in 2004 only lead to many of the problems identified in today's report?

Ms. SHAMES. Yes, they do in a general sense, in that we found in 2004 that USDA was not conducting the oversight in a timely manner, as was required in its regulations. We also found that USDA was not providing or looking for substantiating information to ensure that, in fact, the program recipients were actively engaged in farming. We found that in the file review, that USDA officials did not look for bank account records and other documents that could help ensure that the farm program recipients were eligible for it.

Senator GRASSLEY. All right.

Since I have time left, I will go to Glen. GAO recently reported that USDA made farm program payments to estates more than 2 years after a recipient died without first determining, as required by regulation, whether the estates were kept open primarily to receive these payments.

For example, in 1999 through 2005, USDA did not conduct any eligibility determinations for 73, or 40 percent, of the 181 estates that GAO reviewed. In addition, 69 of the remaining 108 estates did not receive annual determinations for every year of payments received. Of the remaining 39 estates, the agency generally found problems with determinations done, such as missing or insufficient documentation explaining reasons for keeping the estate open.

What action does USDA plan to take to ensure that its field offices are capable—emphasis upon capable—of doing the following: (1) complete required eligibility determinations; and (2) adequately document the reasons for continuing payments beyond 2 years after death?

Mr. KEPPY. Thank you, Senator Grassley. With your permission, I would like to go to a couple of questions ago. Our agency has taken very seriously the recommendations that came out of the GAO report, the three recommendations that you cited and have expressed, that we are reacting to. Our agency has taken very seriously that we do review all estates that have, for more than 2 years, descendants and the management control.

Social Security. We are working diligently to try to work with the Social Security agency to come up with a way that we can use that information. And if there are improper payments, we do have a plan for recovering.

To answer the question that you asked, yes, in 2007 we have issued a notice to our county offices. A national directive was issued that emphasizes the longstanding policy and procedures in regard to the required review of estates older than 2 years.

We will have to make sure that we have proper documents, and our county committees are going to have to do a better job. Some have done a better job, but we have to make sure that all of them do, and make sure that they get documented evidence, make sure, if a person is in the system for more than 2 years, there is a documented trail and evidence of why it has taken place. We take very seriously the responsibility that is given to us to make sure that we look after the American taxpayer and their interest in this particular program.

Senator GRASSLEY. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Salazar, you are next.

Senator SALAZAR. Thank you very much, Chairman Baucus. Of all of the hearings of the Finance Committee that you and Senator Grassley have held, with all the witnesses, on everything from energy to health care, I must admit, this is a set of witnesses that I am most comfortable with. [Laughter.] So, thank you for putting the spotlight on ranchers and farmers in America in our Finance Committee.

I also want to particularly welcome Terry Fankhauser, who is a friend and the executive director of the Colorado Cattlemen's Association. The Colorado Cattlemen's Association, founded in 1867, is the Nation's oldest State cattlemen's association. CCA was one of the first agricultural producer groups in the country to form a conservation land trust, and I was proud to have been a part of that effort early on some, now, 10 years ago.

And through the efforts of the Colorado Cattlemen's Trust as of very recent times, we now have protected about 2,000 acres of farmland that are under conservation easements. So, I appreciate the leadership and example of the Colorado Cattlemen's Association.

As many of you know, I hail from a ranch and farm in the very rural, southern part of Colorado. That farm has been in my family's ownership for over 150 years, ranched by the same ancestors who came to the San Luis Valley in about 1850.

I am a firm believer that we can, and should continue to make sure the livelihood of farming and ranching families across America stays strong and vibrant. I have a sign in my office that I have had there since I was first elected to public office that says "No Farms, No Food." Tom, you, Terry, and others have been to my office and you have often seen those signs from way, way back.

It is a simple slogan, but I try to keep it in mind as I approach agricultural policy, because it speaks to the importance of the agricultural industry and our duty to make sure it continues to be a profitable and gainful line of work.

It is with that duty in mind that I approach my work, both on this committee and on the Agriculture Committee. As a member of those committees, I have been able to put my own agricultural experience to use as an advocate for our Nation's farmers and ranchers.

With the farm bill coming up, I hope to continue to work through my seats on these committees to craft a bill that makes sense for our Nation's farmers and ranchers and for our Nation's long-term fiscal health and our Nation's long-term food security.

In anticipation of that bill and its importance to farmers and ranchers, I am interested today in the issues that we are talking about in this hearing. I am certain there will be more discussion concerning the GAO report that highlights the USDA's ineptness at following its own regulations regarding deceased participants and the commodity safety net. I think it is important for the next farm bill to yet again direct the USDA to run efficient programs that do not have the same gaps that we see in the regulations, as the GAO has found.

With regard to payments of the Conservation Reserve Program, I am a co-sponsor of S. 1155, legislation introduced by Senators Dorgan and Brownback, and also co-sponsored by my fellow com-

mittee member, Senator Roberts, that would clarify that CRP payments are rental income payments and should not be subject to self-employment taxes.

The CRP has been a very successful program in my home State of Colorado, and I am hopeful that this hearing will give my fellow committee members a chance to learn more about that particular legislation.

Additionally, when we consider the farm bill in the coming months, it is my sincere hope that we can include permanent disaster relief in the package. It has been over a decade since we had in place a permanent system to help producers respond to weather-related disasters.

In the interim, Colorado farmers and ranchers have faced calamities ranging from droughts, to blizzards, to tornadoes, and that is the same phenomena that we see happening in many States around the country, as you testified about, Tom.

With the strong support of the members of this committee, I hope that Congress can finally pass the disaster assistance package and hopefully we can get that soon.

Let me just ask a quick question. This is to Tom. You said that we needed a disaster relief program that would be—let me ask this to Terry. You already responded to Max.

The permanent disaster relief program, you said $1 billion to $1.5 billion, is what Tom said. So, Terry, is that the amount that you think is needed? Would you agree with Tom, number one? Number two, what is the funding source? Where do we get the money from? Do you agree with tariffs, the source that Senator Baucus spoke about, or is there another source for us to be able to fund that need?

Mr. FANKHAUSER. Thank you, Senator Salazar. Also, thank you for your continued support of the livestock and agriculture industries.

As we have come to look at disaster assistance, one thing we realized in Colorado very clearly, when we tried to implement a private funding source during this recent blizzard, was that we could be much more efficient at the time of a disaster than we could in the long term—efficiency of use of money as well as lending assistance to those producers 2 and 3 years down the road.

Senator SALAZAR. I understand the policy rationale for it.

Mr. FANKHAUSER. Yes. Yes.

Senator SALAZAR. But my question is, how much money do we need to include in that disaster fund, and where do we get the money from?

Mr. FANKHAUSER. Absolutely. It is hard to put a number on that. I would tend to agree with the colleague to the right of me that I think that number is a place to start. It would allow us to at least then craft a program that would have some activity at the time of disaster.

As far as funding sources, I think creativity is necessary. I know the National Cattlemen's Beef Association and State Cattlemen's Group stand ready and willing to look for and assist with that. But once again, I guess I would concur to say that the starting points that have been mentioned here today are probably the place for us to begin.

Senator SALAZAR. All right. Thank you. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Stabenow?

Senator STABENOW. Thank you, Mr. Chairman. I do not know if we have the most members on Finance Committee and Agriculture, but I would guess that we are pretty close to having the most overlap between these two committees, which I think is really important and really terrific as we look at the farm bill and what really is a food security bill, and energy security, as there are so many opportunities for us. I know we are all very committed to doing the very best that we can related to the farm and food security bill.

First a comment, I guess, in agreeing about permanent disaster relief. I could not agree more with what has been said. I particularly want to include in that, as a State that grows a lot of fruits and vegetables, that in Michigan the tree assistance program for orchards is absolutely critical as a part of that.

In Michigan, in the last 3 years alone we have seen everything from apples to cherries to grapes to sugar beets, and this relates to weather, and it also relates to disease for these crops, which is very much a part of what happens in disasters.

Unfortunately, with specialty crops we do not have the same safety net as program crops, so permanent disaster relief is absolutely critical to these farmers. Unfortunately, as has already been said, we have seen too little, too late. We have farmers operating with very small profit margins, and it makes it very difficult.

But I am wondering, Mr. Buis, when I have talked about permanent disaster relief, oftentimes I hear from people, well, why not just beef up crop insurance? I know the answer to that, but I wonder if you might speak to why crop insurance does not address what we are talking about in terms of a permanent disaster relief program.

Mr. BUIS. Thank you, Senator. First, let me say I think you made some important points about including all commodities. For a number of years we only covered the eight major commodities in disaster assistance, but that has changed over the recent history, and should, because depending upon your crop, you still cannot control the weather, and certainly, as you mentioned, the tree crops.

We have certainly a huge opportunity here to change it. Whether or not we have the money is going to be the big central question. We are not opposed to any creative idea. In fact, we even suggested shifting some of the direct money to pay for emergency disaster assistance. But some producers do not even want to do that, and I can understand why. But how we end up fixing this is going to be the real key.

I think you hit the nail on the head: why not fix crop insurance? Well, over the years that I have been in town, crop insurance has been improved, but it is very costly. The higher levels you go to to cover those shallow losses are very expensive. If you run it through the private industry, it is going to be more expensive than it would through the Federal aid, so you actually can get more coverage for less through a Federal program.

And again, we are not advocating a disincentive for crop insurance. In fact, if you write it properly, it would be an incentive for

producers to buy up at higher levels to get this shallow loss coverage. So, I think the two can work together.

Senator STABENOW. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Next, is Senator Lincoln.

Senator LINCOLN. Thank you, Mr. Chairman. I appreciate you and the ranking member, Senator Grassley, for holding this hearing today. As we begin work on the 2007 farm bill in the Agriculture Committee, I am pleased that the Finance Committee has also engaged in the discussion. There are many members that overlap.

I look forward to working with you, Mr. Chairman, and others to develop tax policy that will be complementary to our ongoing farm policy efforts. I think as we get more and more people engaged in agricultural programs and other issues involved in farm policy, we are starting to realize that agricultural programs can be just as complicated as the tax policy in this country. So, I appreciate the Finance Committee getting engaged.

I know we have a panel of witnesses here to talk about a variety of agricultural issues. To begin with, I feel that I would like to first take a moment to provide my perspective on the recent GAO study that Ms. Shames has discussed.

As one who represents a leading farm State, I care deeply about maintaining the integrity of our U.S. farm policy, and I would associate myself with the words of Senator Grassley that there is no intent, hopefully, here that would threaten the farm safety net program that exists.

More importantly, my Arkansas farm families care deeply about this issue, particularly the integrity of the farm programs, because it is probably one of the oldest issues we deal with here in Congress, agricultural policy and farm policy and maintaining a safe and abundant food and fiber supply.

My Arkansas farm families are hardworking people who do something pretty incredible every day. As I said, they provide us that safe, abundant, and most affordable food and fiber supply in the world, not to mention what they do provide for the rest of the world. Our farm policy makes this possible, and it does so with expenditures of only about one-half of 1 percent of the entire Federal budget.

That is an investment. It is a good investment with a good return. If we think about it as Americans, that we go to the shelves in the grocery store and we look to our farmers to provide us something that we know that they have followed the rules and the regulations that their government has set before them to produce, the safest, most abundant food supply with respect to safety and certainly with respect to the environment.

I think that is something that we can all be proud of. I think it would probably be safe to say that the farm program is one of the few government-sponsored programs that has consistently come in below expected cost since 2002.

With that said, Mr. Chairman, I know that you are just as aware, as I am, of the challenges facing our farms today in the world marketplace that is not free or fair. This committee deals

with trade. When U.S. farmers survey the world, they see an average farm tariff of 62 percent against their products.

Compare that to the 12 percent that our foreign competition sees when they want to send something here to our country. America has said to the world, we are ready to level the playing field for everyone. But the response that we have gotten back from many parts of the globe is that you must bring down your help to your U.S. farmers and we will hang on to ours, thank you very much.

So I think it is important, again, to remember what we do through this farm legislation in terms of making sure that these farm families across our country can continue to provide us with a safe food supply in an ever-changing global world. That is the context in which we have to consider U.S. farm policy.

There are multiple things that certainly affect it, but without a doubt, unfortunately we have become very accustomed in this country to having a safe and affordable food supply, and it is something we should not take for granted as the global marketplaces change.

Now, do I think we ought to enforce our laws strictly and vigorously? Absolutely I do. We want to maintain the integrity and we want to make sure, if there are abuses that exist, that we are going to correct those abuses. I am, as I said, grateful to the chairman and the ranking member for moving forward on this, and several other issues.

What we are talking about today is a limited study, however, particularly from the GAO, of 181 cases where 40 percent of the time-appropriate USDA oversight was not taken. So, I hope we just keep that in the context of what we are discussing. We want to make it very clear in some, and maybe even many, of these instances the estates are legally eligible for these payments.

They should be getting these payments because it is the way that we have structured the law in the farm programs. I am not saying that is right or wrong. I am just saying that we need to make sure that, if what we are going to do is criticized, then we need to make sure of what we are looking at and perhaps how we want to change it.

I know the title is a good headline up there, but I hope we will try and get beyond that today in our discussion and look at how it is that we want to address this and what we can do.

Finally, Mr. Chairman, I want to add that I am a little disappointed, too, that so much of our time is going to be devoted to some of those discussions. I hope that we will take the opportunity here in the Finance Committee to look at the tax issues of consequences that we want to be focusing on here in the committee, and I think we will have a great opportunity.

I know the estate tax is one of the most obvious examples in terms of our family-owned farms. The estate tax structure that we have put into place in 2001 just is not workable for our family farms and businesses and provides no certainty for their planning and for future generations.

I would also like to hear from our farmers about the depreciable life of their equipment. I know that is a big issue as well. The costs associated with meeting government regulations for storing their fertilizer, and something about, the IRS has misclassified their

CRP payments for tax purposes. We have heard a little bit from Senator Salazar as well.

These are all issues that we need to be focusing on, and our farmers are asking for solutions to those issues as well. I hope the committee will have another hearing at some point, either the full committee or the subcommittee level, that could deal with that.

So, thank you, Mr. Chairman. I appreciate you and the ranking member for your strong leadership on behalf of America's farm families, and I hope this is just the first of many conversations in our discussions on agricultural tax policy over the next few months.

Just a couple of questions I would throw out. Mr. Keppy, I know my time is up, but if you could just answer for the record a couple of things. Are you aware of any instances found in this GAO study where an estate was being kept open solely for the purpose of obtaining program benefits? I think you have answered that, or at least alluded to it. I would like to make sure that it is on the record.

Also, as we discuss these issues, maybe for the record you might expand a little bit on the staffing and technology challenges that you do have at USDA. I know in our FSA offices, in working with USDA, those people down in the field are working overtime, overnight. They are doing the best that they can in terms of the resources, in terms of technology, as well as staffing to be able to meet multiple needs that farm families need their assistance on in very complicated programs and other things.

Mr. KEPPY. Thank you, Senator Lincoln. A year and 4 months ago, I was home planting corn—and I have farmed all my life. So when I came to DC, one of my biggest disappointments was the IT that the government had. I thought surely that IT issues were in great shape in Washington, DC for the government; however, it is a little bit like a farmer being accused of using duct tape and bailing wire to keep things going. But I am very proud of the staff at USDA, and FSA in particular, that they have been able to keep the machine running. They have been keeping programs going, delivering——

The CHAIRMAN. With duct tape? [Laughter.]

Mr. KEPPY. With duct tape. Getting the needed programs out to rural America where it does the benefits that you are talking about.

The CHAIRMAN. All right.

Mr. KEPPY. You mentioned integrity.

The CHAIRMAN. I am going to have to ask you to wrap up. We are way over time, Mr. Keppy.

Mr. KEPPY. Integrity is extremely important to me, and I appreciate you mentioning that comment.

The CHAIRMAN. I am going to have to ask you to wrap up. We are way over time here.

Mr. KEPPY. All right.

The CHAIRMAN. Thank you very much.

Next, we have the former chairman of the House Agriculture Committee, a valuable member of this committee, Senator Roberts.

Senator ROBERTS. I thank the chairman. I want to associate my remarks with the anointed champion of production agriculture, Senator Lincoln. I said I was at the beginning of these hearings in

the Agriculture Committee some time ago, but she has made numerous speeches that we go back and figure out that it is the producer out there—not just the farmer and rancher, but the producer—who does produce the food for this country and a troubled and hungry world, and I thank the Senator for this.

I have talked to her about it. I would like to get into a colloquy with her on the Senate floor if we could ever have time to do that. If Republicans could ever talk together with Democrats, we might be able to get it done.

Mr. Chairman, why don't we have IRS here? I know that is not normally a good thing, but I think they should be here. Were they just too busy? I know you asked them.

The CHAIRMAN. They are busy figuring out how to answer this tax gap.

Senator ROBERTS. I see.

The CHAIRMAN. You know, $345 billion a year. They are still working on it.

Senator ROBERTS. All right. Well, I think they ought to be here on the CRP issue, as raised by Senator Salazar, myself, and others, and more especially, you and Senator Grassley.

Let me say to Tom, we have 95-percent sign-up now in the crop insurance program due to the Kerry-Roberts bill. If you are in Nebraska, it is the Kerry-Roberts bill; if you are in Kansas, it is the Roberts-Kerry bill. [Laughter.] And it took us over a year to improve the crop insurance program. We would like to think we have made some progress. Everybody is beating up on it now.

But we have lost our average production history due to the drought, and, when you do not have a crop, your history goes down. To take away from direct payments, which is all we got because of the counter-cyclical nature of the other programs, if you do not have a crop, obviously you do not get any payments.

I do not favor that. I just think that that is a dead-end street, if you are taking away from direct payments to pay crop insurance when your average production history is gone. Somehow or another we have to work out a better situation.

As to this disaster bill fund, I call it the even-numbered disaster fund, because every even-numbered year in my history of six farm bills, any time you set aside a fund for disaster, and we have done it, it is spent in an even-numbered year. I think you know what I am talking about: out-of-condition grain, et cetera, et cetera.

So it will be spent. I think we are better off in trying to assess disasters and then appropriating—a very difficult job—whatever disaster bill we have. Then it is a disaster to pass and a disaster to implement. I understand that. If you had the fund, perhaps we could straighten that out a little bit. And since 2007 has become 2008, now we have a 2-year even-numbered program. So, I worry about that.

Mr. Chairman, thank you for holding this hearing. Again, I want to thank Senator Salazar for bringing up the issue of the CRP and the tax treatment of those payments. The tax treatment of CRP payments is an important issue to both of our States, and last year, 2006, Kansas ranked fourth in CRP grants. Montana, Mr. Chairman, ranked second in the country. I do not know about Iowa, but they are right up there.

I know that you, Senator Grassley, Senator Conrad, myself, Senator Salazar, and others have maintained it was not the intent of Congress—it was not the intent of Congress—that CRP payments should be subject to self-employment tax.

The USDA CRP contract even terms it a rental payment. How IRS can come back and say that, I do not know, but, if finalized, it would clarify that CRP payments, including payments made to retired farmers, are subject to self-employment tax. That is what the IRS has proposed in terms of the rule.

I know the committee is taking a very good look at this issue and how we might resolve the problem. I thank you, Mr. Chairman, for your work on this specific issue. So at any rate, while our witnesses did not touch on this issue, I would like any thoughts in the 41 seconds that we have left.

Can you comment on how we came to be in the situation where CRP payments are subject to self-employment tax? I know the IRS is not here. Do you have any suggestions about how Congress could best clarify it did not intend for CRP payments to be subject to self-employment tax in general, as the IRS set out in its most recent proposed rule last December.

Any comments? The answer is yes, you are for the bill. [Laughter.] Tom, go ahead. Fire away.

Mr. BUIS. Pass the legislation that you referred to. There is similar legislation in the House of Representatives, and do not allow them to use that in the calculation.

Senator ROBERTS. Well, we have a new shotgun rider on this bill, and that is Senator Salazar. He does not give up easy, and the chairman does not give up easy, and Senator Grassley does not give up easy. I know Blanche is with us. I just think, Mr. Chairman, we need to pass this. We need to get it clarified.

The CHAIRMAN. We do. In fact, I am glad you said we do not give up easy, because I know I can speak for Senator Grassley. He does not.

Senator ROBERTS. Well, invite the IRS down. We need a tin can to kick around here every once in a while.

The CHAIRMAN. Yes. We do not need the IRS to get this changed. Thank you. Thank you very much.

I would like to ask you, Dr. Siskin, a word or two about payroll tax exemptions. Just, your sense of how far we go. Some visas are short-term and it is basically a question of the administrative costs of collecting a payroll tax from somebody who is just working for a very short period of time in this country. Or, on the other hand, maybe with up-to-date computers, that can be dealt with pretty forthrightly and fairly efficiently.

But your sense, Doctor. Can you give us some guidance with respect to the management and administrative costs of very short-term visas? Otherwise, I think the rules were pretty broad in their application: if you work in America, you pay payroll taxes. But there may be some occasion where that might not be accurate. Your views?

Dr. SISKIN. I cannot speak to SSA's costs, but we do know that even certain visas where you are not subject to the FICA tax, people are getting Social Security numbers because they are authorized to work in the country, and there may be other taxes that are

taken out that are not FICA taxes. So in terms of Social Security's burden, unfortunately I cannot speak to that. But there are State and local taxes that are taken out for these people.

The CHAIRMAN. There are some State and local taxes. Payroll taxes? Similar to payroll taxes? Are they income taxes? What kinds of taxes locally at the State level?

Dr. SISKIN. It would depend on whether the alien meets the definition of a resident or non-resident alien under the Internal Revenue Code and what the local tax structure is.

The CHAIRMAN. Right. I just think, basically, if someone works in America, that he or she should pay payroll taxes.

I also thank you, Senator Roberts, for bringing up the so-called rental provision under the CRP. I very much believe, frankly—this is not your issue, Dr. Siskin—that that is rental income and therefore payroll taxes should not apply there, or withholding should not apply.

I have no further questions. Senator Grassley?

Senator GRASSLEY. Yes, I do.

I wanted to make a statement, because I read something in the BNA Daily Tax Reporter that I want to refer to. When we debated the budget earlier this year, I raised the scarcity of revenue offsets relative to the demands of tax writing committees and other committees. I am not going to go into those numbers.

Let me just say there is plenty to do on the tax side if we are going to live in the strict pay-go world that we are in now. We will probably need all of our offsets for expiring tax provisions that need to be addressed this year.

So then I referred to the BNA Daily Tax Reporter, and I want to quote from that tax report: "The House Agriculture Committee was expected to file the 2007 farm bill, to the House Rules Committee late July 23 after ironing out arrangements with two other committees that are tasked with supplying about $6.5 billion. After the House Agriculture Committee fell about $4 billion short of its nutrition funding goal, House Speaker Nancy Pelosi and committee Chairman Collin Peterson convinced Ways and Means Committee Chairman Charles Rangel to come up with the money. It remained unclear where the committee will find the offsets for the funding."

So, Mr. Chairman, besides putting that in the record, I would like to make this additional comment. The article indicates that the Agriculture Committee is looking to revenue raises from the energy bill. Now, we need those raisers to make sure that the energy bill remains neutral.

[The article appears in the appendix on p 46.]

Senator GRASSLEY. I do not want to get into any business where we used to do like with Customs fees, do double accounting for offsets, because it does not seem to me that that is intellectually honest for the pay-go regime that we are under now. So I find it a bit ironic that today we have heard testimony about a problem in the farm program, payments to dead farmers.

It seems to me that instead of lifting revenue raises from the tax writing committee, the leadership ought to be looking for more savings in farm programs. Savings from curtailing subsidy payments to dead farmers ought to be looked at quite obviously.

The voters did send a message in November. I heard it loud and clear. But I do not think that voters said "keep spending foolishly and raise taxes." I do not think the American taxpayer would say "raise my taxes and keep making unintended payments to dead farmers."

So I hope that we are careful in this committee with revenue raisers that this committee has largely developed and will continue to develop. They ought to be used for dealing with tax policy first, and we should not become the banker for all other committees. Today we have shown a clear abuse in farm programs. We can save the taxpayer some money by dealing with this problem and keep revenue raisers for tax relief bills.

So, Mr. Chairman, it seems to me that everyone wins under that scenario, and we will be able to meet our responsibilities to the taxpayers as we consider AMT extenders, doctors' payments, and things of that nature.

The CHAIRMAN. Thank you.

Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman. I appreciate it. I appreciate all of your patience.

Just a couple of quick questions left for me. Mr. Fankhauser, I hear from farmers, ranchers, and small businesses back in my home State of Arkansas all the time about the detrimental impact of the current estate tax system and the impact it has on their day-to-day business, the decisions they have to make, planning.

I know some of my colleagues who do not support reasonable estate tax reform like to talk about how it only impacts the most wealthy families, and that it really does not matter to most small businesses, farmers, or ranchers.

However, I do know, working with Senator Grassley and Senator Baucus, that they have great interest in dealing with that issue and the impact that it does have on farmers and ranchers.

I just would like, specifically since we have a real farmer and a real rancher here, if you could explain to the Finance Committee how our ridiculous estate tax structure, which was completely repealed in 2010, to then pop back in at a 55-percent rate and $1 million exemption in 2011, impacts farmers and ranchers.

Mr. FANKHAUSER. Thank you, Senator, for that opportunity. You mentioned something very specifically earlier about certainty, and that is the world that we live in now—we actually lack certainty related to the estate tax.

The farming and ranching community of the United States has enough uncertainty with commodity prices and weather; their estates should not be one of those things that does not have certainty. Obviously, as the cattle industry, NCBA, Colorado Cattlemen's, we do support a full and permanent repeal of the estate tax.

Moving in that direction, any assistance to provide for that level of certainty would be important. The net effect in Colorado is that the assets that we have that are valuable are our land, our livestock, and our equipment.

We are not a society that has a great deal of liquid assets. So the net effect of the estate tax is, in our views, the halving of our livestock operations in rural Colorado. When generational transfer

takes place, in order to offset that estate tax you essentially sell half of your farm or ranch.

Senator LINCOLN. Yes. Thank you. I appreciate that, coming from your perspective and sharing that with our colleagues here on the Senate Finance Committee.

I would also like to associate myself with Senator Salazar's comments about the CRP program and the IRS's determination, or actually lack of. I had sent a letter to the IRS as well and would just associate myself with Senator Roberts and Senator Salazar on that, Mr. Chairman, in the hopes that we could really move something forward. I think it certainly makes sense.

And last, Ms. Shames, in talking about your GAO report, I noticed that the number that you used, which was $1.1 billion over the 1999 to 2005 period, which was the amount of dollars, correct, going to the 172,000 deceased, was that correct?

Ms. SHAMES. Yes.

Senator LINCOLN. Right. You averaged that out as $20 billion per year. But did you take into consideration, after the changes that were made in the 2002 farm bill, the drop in terms of an annual, or did you just average it out over those years?

Ms. SHAMES. Our report actually provides actual dollar figures, breaking out the agricultural programs each year from 1999 to 2005, so we can give you an exact dollar figure for how much went out by program.

Senator LINCOLN. Right. But in terms of averages, I think it is important to note that we did make, and many of us worked together for compromises in terms of how we could reform and put more integrity into these programs in the 2002 bill, and I think you will note that, from the years 2002 or beyond 2002, that the number does fall in terms of the yearly cost in those numbers.

Ms. SHAMES. Yes.

Senator LINCOLN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Salazar?

Senator SALAZAR. Thank you very much, Mr. Chairman.

I want to ask a question about energy and how it is that we might, through this committee, be able to further incentivize what is happening in the farm bill and what is happening with the renewable energy revolution in rural America.

Through the leadership of Senator Baucus and Senator Grassley, we had a very robust Finance package that we did pass out of committee. Unfortunately, we were not able to get it through the Senate yet, but we hopefully will.

My question to Tom and Terry and to Mr. Keppy is, what is it that this committee ought to be doing in terms of how we incentivize renewable energy economic benefits into rural America? Why do we not start with you, Tom, and if each of you could take a minute, minute and a half.

Mr. BUIS. Thank you, Senator. I think it is absolutely critical that you incentivize new renewable energy production. Ethanol started out as gasohol 30 years ago. It was not economically efficient. It was not energy efficient. In fact, the truth be known, most of the real expertise for producing it was probably from backyard stills. But it took that public policy of the incentive on the fuel tax,

it took public policy of investment and to encourage through grants and co-op development of farmers.

Senator SALAZAR. So where do we go from here, Tom?

Mr. BUIS. You have to do the same for all forms of energy, whether it is cellulosic, whether it is wind, whether it is biodiesel. You have to give them a chance to get started.

Senator SALAZAR. Were you satisfied with the Finance package that we passed out of this committee?

Mr. BUIS. Absolutely.

Senator SALAZAR. And what more can we do now as we get to the farm bill, as we deal with title 9 on the farm bill?

Mr. BUIS. Well, depending upon what you ultimately do on an energy bill or a farm bill, to us it does not matter whether it is in the farm bill or the energy bill, but we have to move forward. If we backslide, if we do not take these steps—you know, it takes a lot of lead time to get to where we are, so I would encourage you to cover yourself both ways, farm bill and the energy bill.

Senator SALAZAR. Terry?

Mr. FANKHAUSER. Thank you, Senator. I mean, the cattle industry certainly supports development of alternative energy and new energy sources, specifically from agriculture. I guess our direct comment would be two things. One is that R&D is very important. Research and development is critical in properly funding that for these new emerging markets, these new emerging fuel sources.

One thing related to incentives, as you would expect from the cattle industry, we do not believe in unevenly disadvantaging one segment of the industry over another in relation to those incentives, but R&D is critical.

Senator SALAZAR. All right.

Mr. Keppy?

Mr. KEPPY. I would like to yield to Deputy Administrator John Johnson.

Senator SALAZAR. Mr. Johnson?

Mr. JOHNSON. Senator, I would just refer the committee to the Secretary's proposal for the 2007 farm bill. The Secretary put forth a number of proposals in the energy area. They are not all within the FSA's jurisdiction, which we are familiar with, but there are a number of things in there, promoting research, grants for biofuels, as well as a proposal the Secretary had to prioritize cellulosic ethanol and looking at CRP, perhaps, as a feedstock source for cellulosic ethanol as well.

Senator SALAZAR. Let me ask one question, Mr. Keppy, here with respect to the GAO report. The $1.1 billion that has been referred to in the newspapers and in the GAO report from 1999 to 2005, with the implementation of the recommendations of the GAO and you moving forward with the implementation of your policy changes to deal with that, what kinds of savings do you think we can actually accomplish through the right enforcement of the law and the rules?

Mr. KEPPY. Well, thank you for the question, Senator. In all honesty, I do not think that there actually will be significant savings. I think that, when we get down and steady, all the issues that have been put before us, I think the loss is significant but I think it is

something that we are going to improve upon. In our counties, States, and here in DC, we are going to try to adopt programs.

Senator SALAZAR. And Ms. Shames, what is your response to that conclusion?

Ms. SHAMES. Well, USDA needs to enforce its rules and regulations better. The bottom line is, it just does not know where this $1.1 billion went. And certainly from our examination, it appears that the payments are improper and that they did not go to eligible recipients.

Senator SALAZAR. All right. So would you conclude then that, if the regulations were enforced, that you would have a savings of $1.1 billion over the next 5 or 6 years?

Ms. SHAMES. We would have to see. We would have to see, with the further investigation that USDA does to see if there were any savings.

Senator SALAZAR. My time is up. Thank you very much.

Thank you, Mr. Chairman.

Senator LINCOLN. Mr. Chairman, can I just ask one more?

The CHAIRMAN. Senator Lincoln.

Senator LINCOLN. So you are saying, Ms. Shames, that you believe from your study that the $1.1 billion in payments were improperly done by USDA?

Ms. SHAMES. From our review of matching up the USDA databases with SSA's Death Master List, it certainly appears that the payments did not go to eligible recipients. In our minds, those payments are improper, questionable, suspicious. Yes.

Senator LINCOLN. So you are saying that, just because it went to a deceased person, it is improper, or are you saying that you looked at the law and how it is structured so that if that person, that farmer who dies in April and receives a payment in that crop year, that, as tax law goes, it was improper for that deceased person to get that payment?

Ms. SHAMES. There are legitimate reasons for the payments to be made to estates, and we recognized that. What we found, though, is that USDA cannot demonstrate one way or the other if the payments were distributed appropriately and equitably.

Senator LINCOLN. So it is not your business then to review the tax law to figure out whether or not it was proper or improper. It is your business to just figure out whether or not USDA did the oversight to make sure it was doing——

Ms. SHAMES. I am sorry. We did not look at the tax implications of that. That is right, Senator Lincoln.

Senator LINCOLN. All right. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Thank you all very much for your help and your testimony.

Ms. Shames, I want to apologize to you, I did not pronounce your name correctly at the very beginning. I want to make sure on the record. It is Ms. Shames.

Ms. SHAMES. Thank you.

The CHAIRMAN. Thank you very much.

The hearing is adjourned.

[Whereupon, at 11:34 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

National Farmers Union

Testimony of Tom Buis

Before the

U.S. Senate Committee on Finance

Tax Policy in Farm Country

Tuesday, July 24, 2007
Washington, D.C.

Chairman Baucus, Senator Grassley and members of the committee, thank you for the opportunity to testify on tax policy in farm country. My name is Tom Buis and I am the President of the National Farmers Union (NFU). I commend you for holding this important hearing and look forward to working with you to increase the efficiency, effectiveness and equity of rural tax policy.

NFU is proud to be an organization whose policy positions actually come from producers. NFU polices are written at the local, regional, state and then the national level. Our policy, as adopted at our annual convention in early March, states that the independent family farmer and rancher owned and operated food, fuel and fiber production is the most economically, socially and environmentally beneficial way to meet the needs of our nation. While the economy of rural America faces many challenges, there are also a number of opportunities for growth and revitalization in rural communities. Fuels from the farm and the growing demand for buying fresh and local foods are two ways to return profitability to farm country. New farm products and trends in agriculture marketing have the potential to return profitability and economic opportunity to production agriculture and rural communities. However, producers who wish to take advantage of these new trends face significant cost constraints which can be difficult to overcome without financial assistance in the form of tax incentives.

Last year, NFU held 15 listening sessions throughout the nation. The number one issue of concern among producers was the lack of a permanent disaster program. Farmers and ranchers view the lack of a permanent disaster program as a significant threat to the continued viability of production agriculture. Farmers and ranchers have no control over the weather and can face devastating losses when disasters strike. Without government assistance, farmers and ranchers who suffer from weather-related disasters lose profits and, all too often, their farming operations.

Since 1998, Congress has approved 23 *ad hoc* disaster bills totaling $47 billion. Each time, the U.S. Department of Agriculture (USDA) has to develop and implement what is often a different program. As you know, Congress passed disaster assistance earlier this year for losses that took place in 2005, 2006 and 2007. However, it will not be until late this year or early next year that payments are made. That is a long time to wait for losses that occurred in 2005.

One of the highest priorities for NFU is making *ad hoc* disaster assistance a thing of the past and moving to a permanent disaster program. A permanent disaster program would provide rural Americans with an assured safety net in the event of natural disasters. It would also allow USDA certainty in how the program operates, therefore making the program more efficient and effective with scarce taxpayer dollars, and more timely for producers.

Mr. Chairman, President Eisenhower once said, "Farming looks mighty easy when your plow is a pencil, and you're a thousand miles from the corn field." Well, there are a lot of pencil plowers in Washington, but I am pleased that on this committee there are many members who support American agriculture and know that there are serious issues to be addressed.

I am hopeful that the new farm bill will include permanent disaster assistance and that this Committee will address the related funding issues to ensure that the resources are available for such a program.

I would note that one of the reasons that resources are needed is due to the success of the 2002 Farm Bill. The program worked so well, relying primarily on the counter-cyclical nature of the program, that it did not expend the resources contemplated. As a result, under current budget guidelines, Congress has a reduced budget baseline for which to write the 2007 Farm Bill. It is a shame that budget rules short-change fiscally responsible programs such as the 2002 Farm Bill. The 2002 legislation saved billions of dollars while producers received their income from the marketplace. If all federal programs were as fiscally responsible,

we would have a budget surplus, not a deficit. However, that has left no resources for a new permanent disaster program.

Again, NFU considers permanent disaster assistance a critical and inseparable part of an adequate safety net which should be included as part of the new farm bill. We urge the committee to find the needed resources to allow a permanent disaster provision to be implemented so that *ad hoc* disaster legislation becomes a thing of the past. Producers need some certainty.

Mr. Chairman, I again thank you for holding this hearing and for the opportunity to testify. I would be pleased to take any questions at the appropriate point and look forward to working with you and all members of the committee to craft a thoughtful new farm bill for our nation.

Statement of Senator Jim Bunning
July 24, 2007

Thank you, Mr. Chairman.

I am glad we are taking time today to take a closer look at tax treatment of America's farms and their workers. Like many of my colleagues on this committee, I come from a state that is characterized by family farms and small, close-knit communities. Agriculture has always provided the economic and cultural backbone for Kentucky.

Immigration and employment issues are particularly important to Kentucky's agriculture economy, and I am looking forward to some discussion about FICA tax exemptions for H-2A workers in particular. I recognize the need for some foreign guest workers in our economy, and I support making guest worker programs simpler and more accessible for both workers and employers. But I want to be sure that we do not harm our American workers in the process.

As we consider the future of farming in Kentucky, a lot needs to be done. We need tax relief for farm families by eliminating the death tax and providing tax reform that is friendly to rural communities. Senator McConnell, Senator Lincoln and I recently introduced the Equine Equity Act to level the playing ground for the horse industry versus other businesses under the federal tax code.

I also have serious concerns about a lack of oversight in rewarding disaster assistance and subsidies to farmers. We need to ensure that farm payments go to those that need them and not to line the pockets of those that are doing fine without assistance. I look forward to testimony from the GAO on its recent study.

Family farms and small towns across our nation have made us strong. It's a legacy that we must continue to nurture.

I look forward to asking some questions.

Thank you.

Statement for the Record
Senator Maria Cantwell

Senate Finance Committee Hearing
Oversight of Government Tax Policy in Farm Country
July 24, 2007

Mr. Chairman, Thank you and Senator Grassley for the leadership you have shown on these issues and for holding this important hearing today.

As is the case in most states, a strong and thriving agricultural sector is essential to Washington state's economic success. As we consider the 2007 Farm Bill, it is important that the Finance Committee take a look at the effect our tax policy and farm programs have on our farmers and ranchers.

First, let me echo the comments of my colleagues with respect to the treatment of Conservation Reserve Program (CRP) payments. The payments are based on the rental value of the land and I believe should be treated as rental income. The IRS, however, views the payments in the same way as income from active farming and, as such, they are subject to employment taxes.

This makes a difference to my farmers and I hope the Committee will take a serious look at just what the proper tax treatment should be for these CRP payments.

I look forward to the testimony of the witnesses, especially as it relates to a permanent disaster assistance mechanism. Congress's ability to provide help after a disaster that affects our agricultural sector is slow and inconsistent. We must look for a better way to address these critical needs in a timely fashion.

Many different sectors of agriculture in Washington have suffered due to weather disasters. Recently, our specialty crop industry has been particularly hard hit. I have heard personally from the apple, cherry and pear growers in my state regarding the devastation these weather disasters have caused. In addition to the growers hit hard by adverse weather conditions over the past several years, the hard working men and women in the associated small businesses have suffered as well. These associated small businesses, such as fruit packers and warehouses, are forced to take significant losses and layoff workers when weather disasters make much of the fruit unsalvageable.

Since 2005, Senator Conrad and I have worked to provide assistance not only to the farmers hit by crop losses but also to these associated small businesses. We were successful in getting legislation through the Senate earlier this year to address this concern, only to see the provision was stripped in conference with the House. We will keep trying because their needs still are very real.

It should not take two years or more for Congress to get needed aid to our agricultural businesses. I sincerely hope we can come together on a permanent mechanism for disaster relief to enhance the stability of federal assistance to our farmers.

Thank you again Mr. Chairman for holding this important hearing.

Written Statement of U.S. Senator Byron Dorgan for the Senate Finance Committee Oversight Hearing on Government Tax Policy in Farm Country

July 24, 2007

Chairman Baucus, Ranking Member Grassley and other distinguished Committee members, I appreciate this opportunity to visit with you today about tax policy issues that are extremely important to family farmers and the health of our rural communities. There are a number of tax policies that can be addressed with your continued leadership and support.

Whether enhancing the ability of farmers to write off the high cost of farm equipment and building improvements, or providing expanded energy tax incentives that will provide new market opportunities for family farmers, federal tax laws passed by Congress can mean the difference between keeping family farms operating and well, or making family farmers a forgotten relic of the past. I expect the Finance Committee will be hearing about and examining a number of ideas to help our family farmers not only to survive, but also to prosper.

Today, I want to focus my comments on a couple of tax issues affecting farmers, retired farmers, landowners and other businesses operating in rural communities. First, I want to discuss the Internal Revenue Service's wrong-headed decision on Conservation Reserve Program (CRP) payments. For many years now, the Internal Revenue Service (IRS) has been taking the erroneous position that CRP payments received by farmers are self-employment income derived from a trade or business, and therefore are subject to Self-Employment Contributions Act (SECA) taxes. Regrettably, the IRS and the Treasury Department proposed a new ruling late last year that not only requires active farmers to pay SECA taxes on CRP payments, but expands similar tax treatment to CRP payments received by retired farmers and other landowners.

I know the Chairman and Ranking Member agree that the IRS position is wrong. In fact, you have authored similar language in the past to overturn the IRS's erroneous position. Regrettably, if the IRS's proposed rule is finalized, it will impose an unintended and unfair financial burden on many farmers and other landowners.

Over many years, many farmers have been paid annual rental payments by the U.S. Department of Agriculture for volunteering to place environmentally-sensitive lands out of production for an extended period under the Conservation Reserve Program. During most of this period, the IRS has waged an aggressive campaign to require farmers to pay SECA taxes on those payments. But the IRS's tax treatment of CRP payments is not what Congress intended, nor is it supportable in law. The U.S. Tax Court reviewed this matter and ruled that the IRS's characterization of CRP rental payments as income from self-employment is dead wrong. Unfortunately, the IRS challenged the Tax Court decision and the Tax Court was later reversed by a federal appellate court. And correspondence I received from the IRS officials suggests that the IRS has no intention of changing its position.

Senator Brownback and I have authored bipartisan legislation called the Conservation Reserve Program Tax Fairness Act of 2007 (S. 1155). This legislation, which has the support of 13 of our colleagues, would treat payments under the Conservation Acreage Reserve Program as rentals from real estate and thus not self employment income subject to employment tax. Our bill also has the support of the National Farmers Union and American Farm Bureau Federation.

Today, North Dakota has some 3.4 million acres with about $112 million in rental payments in the CRP program. Left intact, the IRS's ruling would mean that farmers in North Dakota may owe an additional $16 million in federal taxes this coming year. A typical North Dakota farmer with 160 acres of CRP would owe nearly $750 in new self-employment taxes because of the agency's ill-advised position.

If the IRS decides to pursue back taxes on returns filed by farmers in past years, the amount of taxes owed by individual farmers for CRP payments could amount to thousands of dollars. That would be devastating to many farmers and others who depend on CRP rental payments to make ends meet. As a result, the proposed change in S. 1155 applies to CRP payments made in open tax years before, on, or after the date of its enactment.

I expect that you have heard from farmers and other landowners who receive CRP rental payments that are outraged by the IRS's proposed ruling and justifiably so. Quite simply, we cannot allow the IRS's misguided effort to treat CRP rental payments as net earnings from self-employment to stand. We can take steps like those included in S. 1155 to ensure that CRP payments will be treated as rentals from real estate not subject to payroll taxes. I hope you will work with us to get this legislation enacted into law without delay.

Second, I want to take this opportunity to remind my colleagues on the Finance Committee about the silent but continuing economic devastation in rural communities suffering from chronic out-migration. The U.S. Senate understands that the relentless departure loss of people is squeezing the life out of rural towns, and we have made some progress in trying to reverse this problem. However, I would urge the Finance Committee to pass the provisions in legislation I authored with Senators Hagel, Brownback, Johnson and others called the New Homestead Act (S. 1093), which includes tax incentives and other financial rewards to help states develop strategies to encourage individuals and businesses to locate, stay and expand in high out-migration rural communities.

I believe that rural states like Montana, Iowa and others in the heartland and the federal government need to work together to find creative solutions to increase the standard of living in rural towns and to create new jobs, as well as to address the problem of out-migration of people and resources from our rural areas. Left unaddressed, a community can reach a point where, because of continued out-migration, it no longer possesses the critical mass it needs to sustain and reproduce it. You simply can't grow or run a business in an environment where the overall economy is shrinking, where current and potential customers are leaving, and public and private investment are falling.

The Agriculture Committee is working on a new farm bill that will support a network of family-owned and operated food producers. This would give a much-needed boost to the farm economy. But the federal government should also do for rural areas what it did for urban areas a generation ago. At that time, our cities were losing people and jobs, and it was viewed as a national crisis. Our leaders called for "urban renewal," ultimately committing billions of dollars to this cause. And this national call to action made a difference. We can and should do the same for rural communities fighting against out-migration in the Heartland.

In the past, the Finance Committee has supported tax policies to keep rural communities alive and well. With its help today we have a unique opportunity to ensure that Congress enacts a new farm bill and a robust tax package that will be meaningful to family farmers and other businesses in our rural communities.

Testimony

on behalf of the

National Cattlemen's Beef Association

with regard to

Tax Policy in Farm Country

submitted to the

United States Senate - Committee on Finance

The Honorable Max Baucus, Chairman

submitted by

Mr. Terry Fankhauser

Executive Vice President
Colorado Cattlemen's Association

July 24, 2007
Washington, D.C.

National Cattlemen's Beef Association

Good morning, my name is Terry Fankhauser, and I am the Executive Vice President of the Colorado Cattlemen's Association (CCA), and a member of the Executive Committee for the National Cattlemen's Beef Association (NCBA). Founded in 1867, CCA is the nation's oldest state cattlemen's association, serving its members by speaking out on behalf of Colorado's more than 12,000 beef producers. CCA is a state affiliate of NCBA. Producer-directed and consumer-focused, NCBA is the largest and oldest organization representing America's cattle industry, and it is dedicated to preserving the beef industry's heritage and future profitability through leadership in education, marketing and public policy. Thank you Chairman Baucus and Ranking Member Grassley for this opportunity to testify on the importance of our nation's grasslands and the need for a permanent disaster program in this country.

Rangelands and Grasslands

Our nation's rangeland and grasslands are an invaluable resource. America's ranchlands have long played a central role in supporting the nation's scenic beauty, wildlife habitat, and economy—they also support many cattle grazing operations, preserve water quality and quantity, and contribute significantly to our nation's food supply. Nationally, cash receipts for cattle and calves alone total $40 billion annually, and these dollars contribute to the foundations for local economies by supporting businesses such as ranch implement dealers, veterinarian services, hardware and feed stores.

Like many states in the West, the state of Colorado is facing growing development and economic pressures. Recognizing the need to help our ranchers and farmers protect their agricultural lands in the face of these pressures, the Colorado Cattlemen's Association in 1995 formed the Colorado Cattlemen's Agricultural Land Trust (CCALT). CCALT's primary emphasis is to increase awareness among agricultural landowners about the use of conservation easements as a means of protecting land and as a tool for facilitating the inter-generational transfer of productive lands. A number of western state cattle associations have formed agriculture land trusts—together those land trusts have formed the Partnership of Rangeland Trusts (PORT).

It is no surprise that NCBA has long been a supporter of working lands programs. NCBA also supports voluntary conservation programs, which allow our producers to meet their conservation goals, as well as meet the growing regulatory requirements they face. Many of our members have been on the land for generations, and want their children and grandchildren to be able to continue ranching. NCBA believes that the goal of conservation programs should be to maintain a balance between keeping good, well-suited working lands in production, and providing for the conservation of species and natural resources.

The Grassland Reserve Program (GRP) is a relatively new conservation program established with the passage of the 2002 Farm Bill. The intent of the program was to designate the U.S. Department of Agriculture conservation monies for use in purchasing development rights—perpetual conservation easements—on a voluntary basis from grassland owners who desire to permanently preserve their ranchland as a working ranch. These landowners receive compensation for not converting their grasslands to crop land or residential, commercial or industrial development, while continuing to utilize their property for grazing. GRP also allows for shorter term easements and restoration agreements.

Upon implementation, GRP proved to be hugely popular. USDA's Natural Resources Conservation Service (NRCS) only held enrollments 2003 – 2005, and in those three years there was a backlog of 7,500 GRP applications, on over 5 million acres. The unfunded need in those

three years totals an estimated cost of $1 billion. The need and desire for a program that helps preserve open space and working lands is strong.

Our ranches and grasslands keep open spaces open. Our producers, their families, and their communities keep rural America rural. And everyone in the cattle industry is striving to keep on-the-farm jobs on the farm. We need to keep our grasslands and ranchlands in tact, and we need tools—like the Grassland Reserve Program—to help keep our producers on the land and in business.

I would like to highlight the Saguache Creek Corridor Legacy Project as an example of how Farm Bill conservation programs helped to secure a bright future for a Colorado mountain ranching community.

Saguache Creek Corridor Legacy Project:
The Colorado Cattlemen's Agricultural Land Trust (CCALT) has been working cooperatively with landowners and farm bill conservation programs in the Saguache Creek corridor since 1998. This partnership has been formed in order to aid multi-generational ranchers in this area in the perpetual protection of agricultural, historical, and habitat values through the purchase of conservation easements to willing sellers. The Saguache Creek corridor is located in southern Colorado and is situated in the northeast corner of the beautiful and agriculturally significant San Luis Valley. The corridor has a long history of sustaining productive ranches and is the longest remaining stretch of undeveloped highway in western Colorado. This area consists of a narrow ribbon of 19,000 acres of private land stretching 25 miles west from the town of Saguache. These fertile hay meadows and irrigated pastures are surrounded by approximately 350,000 acres of public land administered by the Bureau of Land Management and the Rio Grande National Forest, much of which is leased to private landowners in Saguache to use as pasture for livestock grazing.

In 1997, a small group of the private landowners in the Saguache Creek corridor area approached CCALT regarding ways to protect their ranches, and make sure that they remain in the family for generations to come. The landowners were looking for a way to keep their historic ranching area in tact and in agriculture in the face of growing development pressure. CCALT was very enthusiastic about being approached by such a unique cooperative group of landowners who all shared in the idea of conserving land in the Saguache Creek corridor. The importance of protecting such a large, agriculturally viable landscape in an area facing strong development pressures was immediately recognized by CCALT. CCALT held a workshop for the landowners about using conservation easements as an innovative tool to ensure that these historic ranches continue to remain agriculturally productive for many generations to come. By 2000, the landowners in this area enthusiastically agreed to work in partnership with CCALT to begin protecting their ranchlands with conservation easements.

In order to begin acquiring easements on such a large landscape, CCALT recognized the need by landowners to receive aid in funding in order to help pay the fees necessary to purchase an easement. CCALT approached multiple conservation-based agencies and began applying for grants and funds for easement acquisition from conservation-based programs. CCALT ended up receiving large amounts of funding from farm bill conservation programs including the Farm and Ranch Lands Protection Program (FRPP). CCALT also received funds from Great Outdoors Colorado (GOCO), the National Fish

and Wildlife Foundation (NFWF), and the Division of Wildlife (DOW) in order to aid in the financial costs of conservation easement acquisition.

Jim Coleman was the first landowner in the area to place an easement on his ranch. Jim stated, "The FRPP has provided ranchers with the financial incentive to use conservation easements as a tool for keeping the land in agriculture. The money helps, but it's not all about the money, it's about preserving open space and keeping it around for future generations." Jim's 15,000 acre ranch, the home place of Coleman Natural Meats was protected in 2001.

Tom Goodwin, the District Ranger and Field Office Manager in Saguache has been an important part of the support for this local effort, and recognizes the importance of funders who help landowners put easements on their land. He writes, "By protecting the agricultural lands in the corridor, we protect not only the beauty, but we ensure that the areas abundant wildlife herds of elk, mule deer, bighorn sheep, and pronghorn antelope are protected as well. I commend CCALT's effort in working with Saguache Creek landowners to see that this spectacular landscape of working ranches, scenic vistas, and wildlife habitat is permanently protected."

The Saguache Creek corridor represents a positive example of how private landowners, a land trust, and federal agencies can work together to achieve common goals. The financial aid that was provided by programs such as the FRPP has been a key contributor to the protection of over 9,000 acres of historical ranches in the Saguache Creek corridor. Through CCALT, ranchers, and the farm bill conservation program working in a cooperative effort, many valuable and long standing partnerships have been formed. Most importantly, a new bond has been formed between private landowners in Saguache County and the farm bill program because the landowners now know that the farm bill invests in the integrity of rural communities and agricultural lands in Colorado. Through a cooperative effort, the Saguache Creek corridor project has achieved the goal of protecting an intact and functioning landscape, one that is home to agriculture, wildlife, and recreation uses.

GRP Recommendations

NCBA supports continued funding for the GRP program to help conserve our nation's working grasslands. NCBA also seeks a number of programmatic changes to make GRP more landowner friendly. Unfortunately, many ranchers are skeptical of participating in GRP because they simply don't trust the government. To solve this problem, the 2007 Farm Bill should give USDA more flexibility to allow private land trusts to not only hold GRP easements, but also negotiate the terms of the easements. A major benefit of this approach is if a private land trust negotiates and holds an easement, they can enforce and manage the easement at no ongoing cost to the public. The interest in conservation from the ranching community is tremendous – we just need more flexibility in current programs to make them workable.

We also believe that third parties should be able to use their own easement template for a GRP easement, as long as it includes the necessary grassland conservation restrictions. This would make the program more acceptable to landowners, allow land trusts to apply their expertise in perpetual easement management and administration, and enable GRP dollars to potentially be combined with dollars from other conservation programs.

GRP easements should have the ability to be transferred to other qualified organizations in the event of dissolution or if they are unable to fulfill their easement monitoring responsibilities.

GRP easements should be allowed to transfer to non-profit organizations before reverting to the government in cases where the original easement holder is unable to fulfill its monitoring and enforcement duties. Landowners have proven to be very wary of an easement that defaults automatically to the government, if the land trust is unable to fulfill their monitoring and enforcement obligations. We understand that the government must protect their interest in the easement, but we hope that the Committee will build the flexibility into the program to allow the easement to be transferred to another qualified land trust before it reverts to the government.

The Grassland Reserve Program has been very successful in helping landowners restore and protect grassland while maintaining the acres for grazing and haying. This is in huge contrast to programs that take land out of production, such as the Conservation Reserve Program or CRP.

Conservation Easement Tax Incentives

In 2006, Congress changed the tax incentive for voluntary conservation donations – donations by private landowners that retire development rights to protect significant wildlife, scenic, and historic resources. That change enables family farmers, ranchers, and other moderate-income landowners to get a significant tax benefit for such donations, which simply was not possible under prior law.

That opens the door to voluntary, landowner-led conservation on millions of acres of land across the country. Most such donations are made to local, community-based charities dedicated to keeping land in agriculture, conserving important wildlife habitats, and protecting important open space and historic resources.

Thank you, Chairman Baucus and Ranking Member Grassley, for introducing legislation (S. 469) to make the 2006 incentive a permanent part of tax law. The bill currently has 17 cosponsors, and enjoys bipartisan support. We look forward to seeing S. 469 move through the Finance Committee and be enacted permanently into law, to give landowners certainty as they work through the huge decision of whether to put a portion or all of their property into a conservation easement.

Disaster Assistance

One issue that consistently lingers as a concern to all agricultural producers is the devastating blow that Mother Nature can deal in the form of an unexpected weather event such as a hurricane, wildfire, tornado, blizzard, flood or even prolonged drought. Due to the nature of agricultural production, farmers and ranchers are uniquely vulnerable to these natural disasters, and over the years livestock producers have suffered tremendous losses as a result. As an example, a slew of snowstorms devastated many cattle producers in south-eastern Colorado early this year, and I can tell you that disaster assistance is certainly top of mind for Colorado cattlemen and women.

Before delving into the issue of disaster assistance programs, though, I would like to first thank those members of the Committee that played an instrumental role in bringing about an alteration to Section 1033(e), which provides for deferment of proceeds from weather-related sales of livestock. In a letter to Treasury Secretary Paulson on August 2, 2006, you outlined the need to extend the deferment period for these involuntary conversions to allow producers to replace breeding animals they were forced to sell as a result of natural disasters at a time that is feasible for their operation. The ensuing decision, IRS Notice 2006-82, provides critical flexibility to producers struggling to cope with the effects of drought by allowing them to replace livestock they were forced to liquidate only after the first drought free year for their county. While the primary goal is to prevent the forced sale of livestock due to disaster conditions – I will discuss

potential avenues to help us accomplish this goal later in my testimony – this provision is nonetheless extremely helpful to those producers that can no longer hold onto their animals.

Returning to disaster assistance programs, over the past several years Congress has moved to pass disaster assistance on an ad hoc basis in an effort to help those impacted by these catastrophic events; however, it has become abundantly clear that this 'touch and go' system of addressing agricultural disasters is no longer an effective or viable means of providing timely aid to those in need. By requiring that the programs be funded on an ad hoc basis, producers are left to struggle with the uncertainty that accompanies these situations, including decisions regarding the management, movement and possible sale of animals, as well as purchases of hay and feed. Clearly a different approach is needed. Appreciating that natural disasters will continue to occur, and that prudent fiscal planning could serve the interests of both the Congress and producers on the ground, the establishment of a permanent disaster assistance program would be a beneficial course of action.

Member-driven policy of NCBA supports pursuing adequate funding for livestock disaster assistance programs to aid producers adversely impacted by disaster conditions, and calls for the Secretary of Agriculture to be allowed the authority to quickly obtain funding sufficient to swiftly implement livestock disaster assistance programs. The impact of natural disasters is particularly stinging for cattle producers, because they not only lose feed resources but also the foundation of their business – the factory if you will. Cattle can not be replaced on a whim and for this reason appropriate and timely assistance is especially important. With this in mind, cattle producers would urge the construction of a permanent disaster assistance program that includes three particular Farm Service Agency (FSA) programs: the Livestock Indemnity Program (LIP), the Livestock Compensation Program (LCP), and the Emergency Conservation Program (ECP).

Livestock Indemnity Program: LIP is the only FSA program that has been established to offset death losses suffered due to natural disaster, and for that reason it is of paramount importance for inclusion in any permanent disaster assistance program. LIP is crucial to cattle producers because it provides reimbursement for a percentage of the applicable market value of livestock lost (above normal mortality rates) as a result of the disaster. Producers who've lost livestock as a result of wildfire, blizzard, flood, etc. would be hard pressed to continue on with their business if LIP assistance was unavailable.

Livestock Compensation Program: LCP was originally created in 2002 as an emergency FSA initiative to provide immediate assistance, in the form of direct payments, to livestock producers for damages and losses resulting from natural disaster. In situations where a producer is having significant difficulty in obtaining feed for their animals, such as in the case of a flood or drought, LCP payments offer crucial assistance by providing the producer with funds to secure additional feed. Consistent with this concept, the payment rates for this program have historically been calculated based upon standard feed consumption data.

Emergency Conservation Program: ECP provides emergency funding and technical assistance to farmers and ranchers to rehabilitate lands damaged by natural disasters and of particular interest to beef producers, program funds can be used to provide water to livestock in drought situations. Barns, fences and other infrastructure are absolutely essential to running a farm or ranch operation, and timely assistance to restore any damaged and/or demolished property can make the difference between the dissolution of an operation and its continued success.

Cattle producers firmly believe that in implementing any disaster assistance program the distribution of any funds should be directed to ONLY those producers directly impacted by disaster conditions. Additionally, eligibility criteria for all livestock assistance and compensation programs should be based on livestock and/or forage production losses and these losses should be the foundation of any funding distributed. With regards to LIP, LCP and ECP, FSA has historically required that a loss threshold be met. For example, FSA has previously required that a producer must have suffered a loss of grazing production in an eligible county equivalent to at least a 40-percent loss of normal carrying capacity for a minimum of 3 consecutive months during the production year in order to qualify for disaster assistance program benefits. This is in line with the beliefs of cattle producers, and I would submit that these are vital components for any permanent disaster assistance program.

It is also important to note that beef producers have actively sought out measures to mitigate their risk of loss in the case of weather related disasters. Newly developed programs could hold the key to a universally effective means of accomplishing this goal. The Pasture, Rangeland and Forage (PRF) Insurance Pilot Program, announced by the Risk Management Agency (RMA) last summer, provides livestock producers with the ability to insure against weather related losses in the forage production that their operation depends upon. The PRF program - consisting of a Rainfall Index Pilot which is based on rainfall indices as a means to measure expected production losses, and a Vegetation Index Pilot that uses satellite imagery to determine the productivity of agricultural acreage in order to measure expected production losses - appears to be a vast improvement upon previous RMA products for livestock which producers had found burdensome, unworkable, and ineffective as a risk management tool. Cattle producers applaud the PRF program as a step in the right direction; nevertheless, it is important to recognize that the ability of the program to successfully offset weather related losses is uncertain at this time, and adjustments to the program will almost certainly be needed. Furthermore, because of its 'pilot' designation, the PRF program is limited to only a handful of geographic areas (220 and 110 counties for the Rainfall Index and Vegetation Index, respectively).

NCBA is eager to work with RMA and its partners to ensure that the PRF program and/or other successful preventative risk management instruments rapidly develop into broadly utilized tools. However, as we work toward that objective, I would encourage the Committee to provide for other disaster assistance mechanisms which are needed at this time to assist livestock producers who are dealt a blow by unexpected natural disasters.

Chairman Baucus, thank you again for the opportunity to testify here today. I appreciate your consideration of our views, and I would be happy to answer any questions the Committee may have.

Submitted by Senator Grassley for the hearing record of July 24, 2007, "Oversight of Government Tax Policy in Farm Country"

From **Daily Report for Executives**

Tuesday, July 24, 2007

Farm Bill Moving to House Rules Panel After Other Committees Find $6.5 Billion

By Derrick Cain

The House Agriculture Committee was expected to file its agricultural policy bill, known as the 2007 farm bill, to the House Rules Committee late July 23 after ironing out arrangements with two other committees that are tasked with supplying about $6.5 billion.

After the House Agriculture Committee fell about $4 billion short of its nutrition funding goal, House Speaker Nancy Pelosi (D-Calif.) and committee Chairman Collin Peterson (D-Minn.) convinced House Ways and Means Committee Chairman Charles Rangel (D-N.Y.) to come up with the money.

This move on Pelosi's part came from viewing nutrition funding as "worth the trouble" in part because it could help potentially "front-line" Democrats at election time, according to a Democratic leadership aide.

It remained unclear where the committee will find the offsets for the funding. Further, congressional aides said they expected the nutrition funding provision to be approved by the House Rules Committee without official action from the House Ways and Means Committee.

The House Rules Committee could take up the bill as soon as late July 24, assuming a second hurdle is also cleared.

The farm bill includes an additional $2.5 billion for increases in renewable energy spending outside of the committee's baseline. Peterson has said that the figure is to be offset by savings from House legislation, reducing oil company tax breaks (H.R. 6), which he said would have to be approved, in some manner, by the House Energy and Commerce Committee.

Calls made to the House Ways and Means Committee and the House Energy and Commerce Committee were not immediately returned.

Once at the House Rules Committee, Peterson said he expects the bill to receive the "same open rule" given to the 2002 farm bill. He said he may ask for time limits on amendments, depending on the number of amendments.

The House Rules Committee will set the rule the day before consideration of the bill, which is likely to be July 25 or July 26. Peterson said he believes House action could be complete in one day.

Farm Bill Briefings

Peterson and other committee members are expected to discuss the bill's movement to the floor during a July 24 press briefing. Separately, at a July 24 news briefing, Rep. Ron Kind (D-Wis.) is expected to introduce an amendment that would cut farm subsidies completely. The amendment, he said July 20, would be similar to language the committee's Subcommittee on General Commodities and Risk Management rejected on June 19 (118 DER A-18, 6/20/07).

The proposal, also supported by Rep. Earl Blumenauer (D-Ore.) and Rep. Jeff Flake (R-Ariz.), would establish farmers' savings accounts and allow for greater conservation and renewable energy spending in lieu of direct payments and subsidies.

Also, Sen. Tom Harkin (D-Iowa), chairman of the Senate Agriculture, Nutrition, and Forestry Committee, is expected to discuss progress made on the committee's forthcoming farm bill proposal during a teleconference with reporters July 24.

Testimony of Glen Keppy
Associate Administrator for Programs
Farm Service Agency
United States Department of Agriculture
before the
Committee on Finance
United States Senate
July 24, 2007

Mr. Chairman, and members of the committee, thank you for the opportunity to appear before you to review the Department of Agriculture response the GAO audit, "Federal Farm Programs USDA Need to Strengthen Controls to Prevent Improper Payments to Estates and Deceased Individuals." I am pleased to be able to share administrative procedures and additional oversight steps taken by the Farm Service Agency (FSA) since review the GAO draft report. We will provide a brief overview of our county office review procedure, an update on actions taken by the FSA and additional actions that are in the processing of being implemented.

We appreciate the opportunity to be here today to respond to the recent GAO Report. Before delving into the details, I think it is important to correct a few misconceptions.

First, it is something of a misnomer to describe payments as going to "deceased farmers" in the same manner as people used to joke about dead people voting in Chicago. The statutes passed by Congress recognize that farm payments are really designed to support farming operations rather than individuals. When a family farmer passes away, it is quite often the case that farming operation would continue by the heirs. It would be unfairly disruptive to the operation to have one unfortunate event create an even bigger problem for a farming operation.

Second, the concept of "improper payments," as applied by GAO's report, covers more than just payments made to an ineligible recipient or for an ineligible service, duplicate payments, payments for services not received, and payments that are for the incorrect amount. More specifically, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an "improper payments."

So far as we know, the issue raised by the GAO goes solely to the question of whether FSA can sufficiently document the propriety of the payments that have been made to the estates of deceased farmers. On that limited issue, FSA has made some progress, but still has work to do. We appreciate GAO noting these issues and we are working hard to resolve the situation by taking several steps.

FARM PROGRAM OVERVIEW

The Farm Service Agency (FSA) has responsibility for the administration of multiple commodity and conservation programs under which payments are issued to producers.

Some of these programs have limitations on the amount of payments which may be received by a "person." A "person" for payment limitation purposes may be an individual, or an entity such as a corporation, or the combination of individuals and entities. For example, a corporation and the majority stockholder could be combined as one "person" for payment limitation purposes. Also under these programs, payments may be issued well after the payment was earned. For example, counter-cyclical payments under the Direct and Counter-cyclical Payment Program (DCP) may be issued up to two years and three months after the producer has deceased.

During the course of farming operations, participants die and estates are formed. Often, an individual may have met all eligibility requirements to receive a program payment but dies before the payment is actually issued. In such instances, the payment must be issued to the taxpayer identification number of the individual who actually earned the payment.

Estates are legal entities and may receive program payments if they meet eligibility requirements. FSA has a long standing policy of requiring a review of estates that request program benefits which are still open two years after the year in which the producer died. The purpose of this policy is to make sure that the estate is still in existence and not being kept open only for the purpose of receiving program payments which could not otherwise be received.

GAO AUDIT

GAO recently completed a review of program payments during the years 1999 through 2005. GAO's objectives were to determine the extent to which individual decedents' estates receive farm program benefits beyond the 2 years allowed by the payment eligibility rules, and the extent that estates, as members of entities, receive farm program benefits beyond the 2 years allowed. Also reviewed was the extent to which program payments were issued to deceased individuals.

In the audit, GAO questioned the level of documentation used to support the determinations made by county committees that an estate was not kept open for the purpose of obtaining program payments. Some county committees did a more comprehensive review than others. In addition, FSA did not complete the reviews of active estates as diligently as required by policy. However, GAO did not find any instance in this sample of an estate being kept open only for the purpose of obtaining program benefits. In other words, no fraud was detected.

FSA issued over $130 billion in farm program payments and benefits for the years 1999 through 2005. GAO found that during this period, FSA issued a significant number of farm program payments to deceased individuals. It should be noted that again GAO made no findings of waste, fraud or abuse in this review.

I want to be clear about the fact that there are several circumstances under which it is legal for payments to be issued to deceased individuals. In fact, in some cases, we are

required to issue such payments. I appreciate this opportunity to outline a few of those circumstances.

One example that GAO fails to recognize is that under DCP, counter-cyclical payments may be legally issued up to two years and three months after program enrollment. The same taxpayer identification number must be used for the entire program payment period to properly track the issuance of program benefits. It is not mentioned by GAO that 60 percent of the payments in question were issued less than 3 years after the date of death.

Another example relates to disaster assistance. Crop loss and livestock disaster assistance programs disburse benefits after the emergency has occurred. The applicant obviously would not have been deceased at the time of application or when the disaster losses occurred. However, by the date of payment disbursement, the applicant may have died. In such an instance, the disaster assistance would be issued under the taxpayer identification number of the now deceased individual for the surviving spouse and heirs of the family farm. This support is rightfully and legally theirs. Such a situation could arise under recently enacted disaster legislation which provides disaster benefits for crop years 2005, 2006, and part of 2007, even though signup for this program is not scheduled to begin until later this year. This discrepancy could lead to producers who had crops in one of these years but died before being eligible for disaster payments. For the estate to obtain the payment, they would have to use the producer's taxpayer ID, resulting in legitimate payments being made even several years after the producer died.

A third example of legitimate payments to deceased persons involves estates entangled in litigation. Payments to these estates can sometimes be extended by several years due to the litigation. Again, although the named recipient might be deceased, the estate legitimately continues receiving the payments until legal issues are resolved.

It is important to note that GAO concluded that 58 percent of the questioned farm program payments were not made to deceased individuals at all or to their estates, but rather to entities in which they held an interest when they were alive. In other words, more than half of the payments went to entities which we have no reason to believe were ineligible. GAO noted that the complex nature of some types of farming entities makes it more difficult for FSA to determine if the producer information is accurate.

GAO also pointed out that FSA is reliant on the farming operations to self-certify that the information provided is accurate, and that the operation will timely inform FSA of any operational changes, including the death of an interest holder. FSA is working on a system that will change this reliance on self-certification. We plan to obtain information from the Social Security Administration's database as a means of determining that a payment recipient is deceased.

I want to stress again that GAO made no findings that FSA made improper payments to any entities that were otherwise eligible even though a change of stockholders may have occurred with the entity due to death.

AGENCY ACTIONS

In response to the GAO report, FSA implemented several courses of action that follow the guidance recommended by the report.

As I referenced a moment ago, an FSA directive issued to field offices in May 2007 required the review of all active estates in existence for more than 2 years and are to receive 2007 payments. These reviews are to be completed by August 31. All state FSA offices must report this information to the National Office by September 15, 2007. These reviews will be completed prior to the issuance of final 2007 DCP and Conservation Reserve Program (CRP) payments on or about October 1, 2007.

To assist the field offices, a list of all active estates on record at FSA with a creation date of 2004 was provided to all offices on June 19, 2007. A listing of active estates on record at FSA with a creation date of 2004 and earlier, and that received 2006 program benefits, was provided on July 10, 2007.

I mentioned our efforts to coordinate with the Social Security Administration and I'll share with you a little more detail about how that would work. FSA would utilize a data-matching process similar to the process that GAO used in the audit. Data from the Social Security Administration's Death Master File will be compared with FSA producer payment history files and the Service Center Information Management Systems. This will provide a means of identifying deceased producers before the issuance of payments. FSA will not be in total reliance on the information being provided from program participants of certain changes in entities due to death of stockholders.

SUMMARY

Mr. Chairman, while GAO has identified weaknesses, FSA has taken steps to remedy these weaknesses and to put in place additional safeguards against improper payments. As mentioned, estates are legitimate entities that may be determined eligible to receive program payments. FSA issued directives for a thorough review of agency records for the completion of the required reviews of estates for program payment eligibility purposes. Steps have been taken with Agency Information Technology personnel for the linkage of information from the Social Security Administration's Death Master File with Agency producer files to identify deceased individuals and to determine if the issuance of a program payment is appropriate.

We are committed to ensuring that payments are accurately calculated and properly issued. We appreciate the interest by GAO and this committee in holding us accountable for the payments we administer.

Mr. Chairman, thank you for the opportunity to provide this testimony. I would be happy to respond to questions of committee members at this time.

United States Government Accountability Office

GAO

Testimony
Before the Committee on Finance,
U.S. Senate

For Release on Delivery
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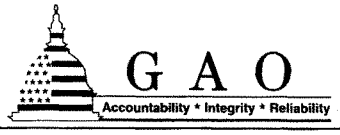
FEDERAL FARM PROGRAMS

USDA Needs to Strengthen Management Controls to Prevent Improper Payments to Estates and Deceased Individuals

Statement of Lisa Shames, Director
Natural Resources and Environment



GAO-07-1137T

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-07-1137T, a testimony before the Committee on Finance, U.S. Senate

July 24, 2007

FEDERAL FARM PROGRAMS

USDA Needs to Strengthen Management Controls to Prevent Improper Payments to Estates and Deceased Individuals

Why GAO Did This Study

Farmers receive about $20 billion annually in federal farm program payments, which go to individuals and "entities," including corporations, partnerships, and estates. Under certain conditions, estates may receive payments for the first 2 years after an individual's death. For later years, the U.S. Department of Agriculture (USDA) must determine that the estate is not being kept open primarily to receive farm program payments.

This testimony is based on GAO's report, *Federal Farm Programs: USDA Needs to Strengthen Controls to Prevent Improper Payments to Estates and Deceased Individuals* (GAO-07-818, July 9, 2007). GAO discusses the extent to which USDA (1) follows its regulations that are intended to provide reasonable assurance that farm program payments go only to eligible estates and (2) makes improper payments to deceased individuals.

What GAO Recommends

GAO recommended that USDA conduct all required annual estate eligibility determinations, implement management controls to verify that an individual receiving program payments has not died, and in cases of improper payments, recover the appropriate amounts. USDA agreed with these recommendations and has begun actions to implement them, such as directing its field offices to review the eligibility of all estates open for more than 2 years.

www.gao.gov/cgi-bin/getrpt?GAO-07-1137T.

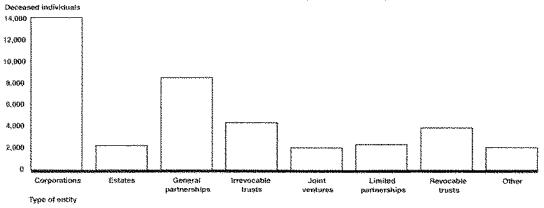
To view the full product, including the scope and methodology, click on the link above. For more information, contact Lisa Shames at (202) 512-3841 or shamesl@gao.gov.

What GAO Found

USDA has made farm program payments to estates more than 2 years after recipients died, without determining, as its regulations require, whether the estates were kept open to receive these payments. As a result, USDA cannot be assured that farm payments are not going to estates kept open primarily to obtain these payments. From 1999 through 2005, USDA did not conduct any of the required eligibility determinations for 73, or 40 percent, of the 181 estates GAO reviewed. Sixteen of these 73 estates had each received more than $200,000 in farm payments, and 4 had each received more than $500,000. Only 39 of the 181 estates received all annual determinations as required. Even when FSA conducted determinations, we found shortcomings. For example, some USDA field offices approved groups of estates for payments without reviewing each estate individually or without a documented explanation for keeping the estate open.

USDA also cannot be assured that it is not making improper payments to deceased individuals. For 1999 through 2005, USDA paid $1.1 billion in farm payments in the names of 172,801 deceased individuals (either as an individual recipient or as a member of an entity). Of this total, 40 percent went to those who had been dead for 3 or more years, and 19 percent to those dead for 7 or more years. Most of these payments were made to deceased individuals indirectly (i.e., as members of farming entities). For example, over one-half of the $1.1 billion in payments went through entities from 1999 through 2005. In one case, USDA paid a member of an entity—deceased since 1995—over $400,000 in payments for 1999 through 2005. USDA relies on a farming operation's self-certification that the information it provides USDA is accurate; operations are also required to notify USDA of any changes, such as the death of a member. Such notification would provide USDA with current information to determine the eligibility of the operation to receive payments. The complex nature of some farming operations—such as entities embedded within other entities—can make it difficult for USDA to avoid making payments to deceased individuals.

Number of Deceased Individuals Receiving Farm Payments through Entities, 1999-2005



Source: GAO's analysis of USDA's data.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the U.S. Department of Agriculture's (USDA) actions to prevent improper payments to estates and deceased individuals. My testimony today is based on our report just released on this subject, which was requested by the Ranking Member of the Senate Committee on Finance.[1] Farmers receive about $20 billion annually in federal farm program payments for crop subsidies, conservation practices, and disasters. The magnitude of these payments, along with our work showing that USDA's enforcement of support program rules is not always effective, is why we observed in November 2006, that USDA needs to provide better oversight of farm program payments.[2] Without better oversight to ensure that farm program funds are spent as economically, efficiently, and effectively as possible, we pointed out, USDA has little assurance that these funds benefit the agricultural sector as intended.

Currently, farm program payments go to 1.7 million recipients, both individuals and "entities," including corporations, partnerships, and estates. The Agricultural Reconciliation Act of 1987 (1987 Act) limits payments to individuals and entities that are "actively engaged in farming." We reported in 2004 that because USDA's regulations ensuring that recipients are actively engaged in farming do not specify measurable standards, they allow individuals with limited involvement in farming to qualify for farm program payments.[3] Individuals may receive farm program payments indirectly through as many as three entities.[4]

[1]GAO, *Federal Farm Programs: USDA Needs to Strengthen Controls to Prevent Improper Payments to Estates and Deceased Individuals*, GAO-07-818 (Washington, D.C.: July 9, 2007).

[2]GAO, *Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

[3]GAO, *Farm Program Payments: USDA Needs to Strengthen Regulations and Oversight to Better Ensure Recipients Do Not Circumvent Payment Limitations*, GAO-04-407 (Washington, D.C.: April 30, 2004). We recommended that USDA strengthen its regulations for active engagement in farming.

[4]Under the "three-entity rule," a person—an individual or entity—can receive program payments through no more than three entities in which the person holds a substantial beneficial interest. A person can receive payments (1) as an individual and as a member of no more than two entities or (2) through three entities and not as an individual. FSA defines a substantial beneficial interest as 10 percent or more.

From 1999 through 2005, USDA, through its Farm Service Agency (FSA), made 124 million farm program payments totaling about $130 billion. Over $200 million of this amount went to nearly 42,000 estates. Under certain conditions, estates may receive payments for the first 2 years after an individual's death. For later years, FSA must determine that the estate is not being kept open primarily to receive farm program payments.

Today, I would like to discuss the two key findings in our report. First, FSA made farm program payments to estates more than 2 years after recipients had died without determining whether the estates were being kept open primarily for the purpose of receiving these payments, as its regulations require. As a result, FSA cannot be assured that farm program payments made to these estates are proper. According to FSA field officials, many eligibility determinations were either not done or not done thoroughly, in part because of a lack of sufficient personnel and time, as well as competing priorities for carrying out farm programs.

Second, we found that FSA unknowingly paid $1.1 billion in farm program payments in the names of 172,801 deceased individuals (either as an individual or as a member of an entity) from 1999 through 2005. FSA cannot be assured that the farm payments it made are proper because it does not have management controls, such as computer matching, to verify that it is not making payments to deceased individuals. Instead, FSA relies on self-certifications by farming operations that the information provided is accurate and that the operations will inform FSA of any changes, including the death of an operation's member.

We have referred the cases of improper payments we identified to USDA's Office of Inspector General for further investigation. USDA agreed with our recommendations for improving USDA's ability to prevent improper payments to estates and deceased individuals and already has begun to take actions to implement them. In particular, USDA has directed its field offices to review the eligibility of all estates that have been open for more than 2 years and requested 2007 farm program payments.

We conducted our review from June 2006 through May 2007 in accordance with generally accepted government auditing standards. To perform our work, we reviewed a nonrandom sample of estates based, in part, on the amount of payments an estate received. We also compared the payment recipients in USDA's databases with individuals that the Social Security Administration has identified as deceased in its Death Master File.

FSA Does Not Systematically Determine the Eligibility of Estates for Farm Program Payments and Cannot Be Assured That Payments Are Proper

While many estates are kept open for legitimate reasons, we found that FSA field offices do not systematically determine the eligibility of all estates kept open for more than 2 years, as regulations require, and when they do conduct eligibility determinations, the quality of the determinations varies. Without performing annual determinations, an essential management control, FSA cannot identify estates being kept open primarily to receive these payments and be assured that the payments are proper.

Generally, under the 1987 Act, once a person dies, farm program payments may continue to that person's estate under certain conditions. For most farm program payments, USDA regulations allow an estate to receive payments for the first 2 years after the death of the individual if the estate meets certain eligibility requirements for active engagement in farming. Following these 2 years, the estate can continue to receive program payments if it meets the active engagement in farming requirement and the local field office determines that the estate is not being kept open primarily to continue receiving program payments. Estates are commonly kept open for longer than 2 years because of, among other things, asset distribution and probate complications, and tax and debt obligations. However, FSA must annually determine that the estate is still active and that obtaining farm program payments is not the primary reason it remains open.

Our review of FSA case file documents found the following.

First, we found FSA did not consistently make the required annual determinations. Only 39 of the 181 estates we reviewed received annual eligibility determinations for each year they were kept open beyond the initial 2 years FSA automatically allows, although we found shortcomings with these determinations, as discussed below. In addition, 69 of the 181 estates had at least one annual determination between 1999 and 2005, but not with the frequency required. Indeed, the longer an estate was kept open, the less likely it was to receive all required determinations. For example, only 2 of the 36 estates requiring a determination every year over the 7-year period, 1999 through 2005, received all seven required determinations.

FSA did not conduct any program eligibility determinations for 73, or 40 percent, of the 181 estates that required a determination from 1999 through 2005. Because FSA did not conduct the required determinations, the extent to which these estates remained open for reasons other than for obtaining program payments is not known. Sixteen of these 73 estates

received more than $200,000 in farm program payments and 4 received more than $500,000 during this period. In addition, 22 of the 73 estates had received no eligibility determinations during the 7-year period we reviewed, and these estates had been open and receiving payments for more than 10 years. In one case, we found that the estate has been open since 1973.

The following estates received farm program payments but did not receive FSA eligibility determinations for the period we reviewed:

- A North Dakota estate received farm program payments totaling $741,000 from 1999 through 2003.
- An Alabama estate—opened since 1981—received payments totaling $567,000 from 1999 through 2005.
- Two estates in Georgia—opened since 1989 and 1996, respectively—received payments totaling more than $330,000 each, from 1999 through 2005.
- A New Mexico estate, open since 1991, received $320,000 from 1999 through 2005.

Second, even when FSA conducted at least one eligibility determination, we found shortcomings. FSA sometimes approved eligibility for payments when the estate had provided insufficient information—that is, either no information or vague information. For example, in 20 of the 108 that received at least one eligibility determination, the minutes of FSA county committee meetings indicated approval of eligibility for payments to these estates, but the associated files did not contain any documents that explained why the estate remained active. FSA also approved eligibility on the basis of insufficient explanations for keeping the estate open. In five cases, executors explained that they did not want to close the estate but did not explain why. In a sixth case, documentation stated that the estate was remaining active upon the advice of its lawyers and accountants, but did not explain why.

Some FSA field offices approved program payments to groups of estates kept open after 2 years without any apparent determination. In one case in Georgia, minutes of an FSA county committee meeting listed 107 estates as eligible for payments by stating that the county committee approved all estates open over 2 years. Two of the estates on this list of 107 were part of the sample that we reviewed in detail. In addition, another 10 estates in

our sample, from nine different FSA field offices, were also approved for payments without any indication that even a cursory determination had been conducted.

Third, the extent to which FSA field offices make eligibility determinations varies from state to state, which suggests that FSA is not consistently implementing its eligibility rules. Overall, FSA field offices in 16 of the 26 states we reviewed made less than one-half of the required determinations of their estates from 1999 to 2005. The percentage of estates reviewed by FSA ranged from 0 to 100 percent in the states we reviewed.

Eligibility determinations could also uncover other problems. Under the three-entity rule, individuals receiving program payments may not hold a substantial beneficial interest in more than two entities also receiving payments. However, because a beneficiary of an Arkansas estate we reviewed received farm program payments through the estate in 2005, as well as through three other entities, the beneficiary was able to receive payments beyond what the three-entity rule would have allowed. FSA was unaware of this situation until we brought it to officials' attention, and FSA has begun taking steps to recover any improper payments. Had FSA conducted any eligibility determinations for this estate during the period, it might have determined that the estate was not eligible for these payments, preventing the beneficiary from receiving what amounted to a payment through a fourth entity.

We informed FSA of the problems we uncovered during the course of our review. According to FSA field officials, a lack of sufficient personnel and time, and competing priorities for carrying out farm programs explain, in part, why many determinations were either not conducted or not conducted thoroughly. Nevertheless, officials told us that they would investigate these cases for potential receipt of improper payments and would start collection proceedings if they found improper payments.

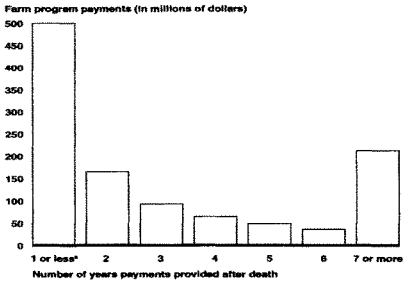
Without Appropriate Management Controls, FSA Cannot Be Assured That It Is Not Making Payments to Deceased Individuals

FSA cannot be assured that millions of dollars in farm program payments it made to thousands of deceased individuals from fiscal years 1999 through 2005 were proper because it does not have appropriate management controls, such as computer matching, to verify that it is not making payments to deceased individuals. In particular, FSA is not matching recipients listed in its payment databases with individuals listed as deceased in the Social Security Administration's Death Master File. In addition, complex farming operations, such as corporations or general partnerships with embedded entities, make it difficult for FSA to prevent improper payments to deceased individuals.

FSA Made Millions of Dollars in Farm Program Payments to Deceased Individuals from Fiscal Years 1999 through 2005

FSA paid $1.1 billion in farm program payments in the names of 172,801 deceased individuals—either as individuals or as members of entities, from fiscal years 1999 through 2005, according to our matching of FSA's payment databases with the Social Security Administration's Death Master File. Of the $1.1 billion in farm payments, 40 percent went to individuals who had been dead for 3 or more years, and 19 percent went to individuals who had been dead for 7 or more years. Figure 1 shows the number of years in which FSA made farm program payments after an individual had died and the value of those payments.

Figure 1: Number of Years and Value of Farm Program Payments Made after Individuals' Deaths, Fiscal Years 1999 through 2005



Source: GAO's analysis of FSA's and Social Security Administration's data.

Note: Farm program payments made through entities are based on program year data.

*Includes payments made 1 day after death to 1 year after death.

We identified several instances in which FSA's lack of management controls resulted in improper payments to deceased individuals. For example, FSA provided more than $400,000 in farm program payments from 1999 through 2005 to an Illinois farming operation on the basis of the ownership interest of an individual who had died in 1995.[5] According to FSA's records, the farming operation consisted of about 1,900 cropland acres producing mostly corn and soybeans. It was organized as a corporation with four shareholders, with the deceased individual owning a 40.3-percent interest in the entity. Nonetheless, we found that the deceased individual had resided in Florida. Another member of this farming operation, who resided in Illinois and had signature authority for the operation, updated the operating plan most recently in 2004 but failed to notify FSA of the individual's death. The farming operation therefore continued to qualify for farm program payments on behalf of the deceased individual. As noted earlier, FSA requires farming operations to certify that they will notify FSA of any change in their operation and to provide true and correct information. According to USDA regulations, failure to do so may result in forfeiture of payments and an assessment of a penalty. FSA recognized this problem in December 2006 when the children of the deceased individual contacted the FSA field office to obtain signature authority for the operation. FSA has begun proceedings to collect the improper payments.

USDA recognizes that its farm programs have management control weaknesses, making them vulnerable to significant improper payments. In its FY 2006 Performance and Accountability Report to the Office of Management and Budget, USDA reported that poor management controls led to improper payments to some farmers, in part because of incorrect or missing paperwork.[6] In addition, as part of its reporting of improper payments information, USDA identified six FSA programs susceptible to significant risk of improper payments with estimated improper payments totaling over $2.8 billion in fiscal year 2006, as shown in table 1.

[5]In addition, before the period of our review the operation received farm program payments on behalf of the deceased individual from 1995 through 1998.

[6]See U.S. Department of Agriculture, *FY 2006 Performance and Accountability Report* (Washington, D.C.: Nov. 15, 2006).

Table 1: USDA Estimates of Improper Payments, Fiscal Year 2006

Dollars in millions		
Program	**Estimated improper payments**	**Percent error rate**
Direct and Counter-Cyclical Payments Program	$424	4.96
Conservation Reserve Program	64	3.53
Disaster assistance programs[a]	291	12.30
Noninsured Assistance Program[b]	25	22.94
Loan deficiency payments provided under the Marketing Assistance Loan Program	443	9.25
Other benefits provided under the Marketing Assistance Loan Program	1,611	20.26
Total/average	**$2,858**	**11.17**

Source: USDA's FY 2006 Performance and Accountability Report.

Note: USDA's estimates include improper payments made to deceased individuals but USDA does not separate these payments from other improper payments.

[a]Disaster assistance payments are direct federal payments to crop producers when either planting is prevented or crop yields are abnormally low because of adverse weather and related conditions.

[b]The Noninsured Assistance Program provides financial assistance to producers of non-insured crops when low yields, loss of inventory, or prevented planting occur due to natural disasters. Assistance is limited to crops not eligible for coverage under the federal crop insurance program.

Complex Farming Operations Raise the Potential for Improper Payments to Deceased Individuals

Farm program payments made to deceased individuals indirectly—that is, as members of farming entities—represent a disproportionately high share of post-death payments. Specifically, payments to deceased individuals through entities accounted for $648 million—or 58 percent of the $1.1 billion in payments made to all deceased individuals from 1999 through 2005. In contrast, payments to all individuals through entities accounted for $35.6 billion—or 27 percent of the $130 billion in farm program payments FSA provided from 1999 through 2005.

The complex nature of some types of farming entities, in particular, corporations and general partnerships, increases the potential for improper payments. For example, a significant portion of farm program payments went to deceased individuals who were members of corporations and general partnerships. Deceased individuals identified as members of corporations and general partnerships received nearly three-quarters of the $648 million that went to deceased individuals in all entities. The remaining one-quarter of payments went to deceased individuals of other types of entities, including estates, joint ventures,

limited partnerships, and trusts. With regard to the number of deceased individuals who received farm program payments through entities, they were most often members of corporations and general partnerships. Specifically, of the 39,834 deceased individuals who received farm program payments through entities, about 57 percent were listed in FSA's databases as members of corporations or general partnerships.

Furthermore, of the 172,801 deceased individuals identified as receiving farm program payments, 5,081 received more than one payment because (1) they were a member of more than one entity, or (2) they received payments as an individual and were a member of one or more entities.

According to FSA field officials, complex farming operations, such as corporations and general partnerships with embedded entities, make it difficult for FSA to prevent making improper payments to deceased individuals. In particular, in many large farming operations, one individual often holds signature authority for the entire farming operation, which may include multiple members or entities. This individual may be the only contact FSA has with the operation; therefore, FSA cannot always know that each member of the operation is represented accurately to FSA by the signing individual for two key reasons. First, it relies on the farming operation to self-certify that the information provided is accurate and that the operation will inform FSA of any operating plan changes, which would include the death of an operation's member. Such notification would provide USDA with current information to determine the eligibility of the operation to receive the payments. Second, FSA has no management controls, such as computer matching of its payment databases with the Social Security Administration's Death Master File, to verify that an ongoing farming operation has failed to report the death of a member.

Conclusions

FSA has a formidable task—ensuring that billions of dollars in program payments are made only to estates and individuals that are eligible to receive them. The shortcomings we have identified underscore the need for improved oversight of federal farm programs. Such oversight can help to ensure that program funds are spent as economically, efficiently, and effectively as possible, and that they benefit those engaged in farming as intended.

In our report, we recommended that USDA conduct all required annual estate eligibility determinations, implement management controls to verify that an individual receiving program payments has not died, and determine if improper payments have been made to deceased individuals or to

entities that failed to disclose the death of a member, and if so, recover the appropriate amounts. USDA agreed with these recommendations and has already begun actions to implement them.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other Members of the Committee may have.

Contact and Staff Acknowledgments

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. For further information about this testimony, please contact Lisa Shames, Director, Natural Resources and Environment, (202) 512-3841 or shamesl@gao.gov. Key contributors to this testimony were James R. Jones, Jr., Assistant Director; Thomas M. Cook; and Carol Herrnstadt Shulman.

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-04-407, a report to the Chairman, Committee on Finance, U.S. Senate

Why GAO Did This Study

Farmers receive about $15 billion annually in federal farm program payments to help produce major commodities, including corn, cotton, rice, and wheat. The Farm Program Payments Integrity Act of 1987 (1987 Act) limits payments to individuals and entities—such as corporations and partnerships—that are "actively engaged in farming." GAO (1) determined how well USDA's regulations limit payments, (2) assessed USDA's oversight of the act, and (3) summarized the distribution of farm payments by type of entity.

What GAO Recommends

GAO recommends that USDA (1) develop measurable requirements defining a significant contribution of active personal management; (2) clarify regulations and guidance as to what constitutes a scheme or device to effectively evade payment limitations; (3) improve its sampling method for selecting farming operations for review; and (4) develop controls to ensure all available tools are used to assess compliance with the act.

In commenting on this report, USDA agreed to act on most of our recommendations. However, USDA stated that its current regulations are sufficient for determining active engagement in farming and assessing whether operations are schemes or devices to evade payment limitations. We still believe measurable standards and clarified regulations would better assure the act's goals are realized.

www.gao.gov/cgi-bin/getrpt?GAO-04-407

To view the full product, including the scope and methodology, click on the link above. For more information, contact Lawrence J. Dyckman, (202) 512-3841 or dyckmanl@gao.gov..

April 2004

FARM PROGRAM PAYMENTS

USDA Needs to Strengthen Regulations and Oversight to Better Ensure Recipients Do Not Circumvent Payment Limitations

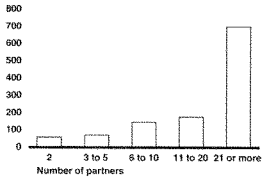
What GAO Found

USDA's regulations to ensure recipients are actively engaged in farming do not specify a measurable standard for what constitutes a significant contribution of active personal management. By not specifying such a measurable standard, USDA allows individuals who may have limited involvement with the farming operation to qualify for payments. According to GAO's survey of USDA's compliance reviews, about 99 percent of payment recipients asserted they met eligibility requirements through active personal management. USDA's regulations lack clarity as to whether certain transactions and farming operation structures that GAO found could be considered schemes or devices to evade, or that have the effect of evading, payment limitations. Under the 1987 Act, if a person has adopted such a scheme or device, then that person is not eligible to receive payments for the year in which the scheme or device was adopted or the following year. Because it is not clear whether fraudulent intent must be shown in order to find that a person has adopted a scheme or device, USDA may be reluctant to pursue the question of whether certain farming operations, such as the ones GAO found, are schemes or devices.

According to GAO's survey and review of case files, USDA is not effectively overseeing farm program payments. That is, USDA does not review a valid sample of farm operation plans to determine compliance and thus does not ensure that only eligible recipients receive payments, and compliance reviews are often completed late. As a result, USDA may be missing opportunities to recoup ineligible payments. For about one-half of the farming operations GAO reviewed for 2001, field offices did not use available tools to determine whether persons were actively engaged in farming.

Of the $17 billion in payments USDA distributed to recipients in 2001, $5.9 billion went to about 140,000 entities. According to GAO's analysis of USDA's data, corporations and general partnerships represented 39 and 26 percent of these entities, respectively. General partnerships received 45 percent of the payments to entities, or $2.7 billion; these entities receive more payments if they have more partners.

Average Farm Program Payments to General Partnerships, by Number of Partners, 2001
Dollars in thousands



Source: GAO analysis of FSA data.

Testimony before the U.S. Senate
Committee on Finance
Hearing on Oversight of Government Tax Policy in Farm Country
By
Alison Siskin, Ph.D.
Specialist in Immigration Policy
Domestic Social Policy Division
Congressional Research Service

July 24th, 2007

Thank you Chairman Baucus, Ranking Member Grassley, and Distinguished Members of the Committee for the invitation to appear before you today to speak about the visa categories which are exempt from Social Security Federal Insurance Contribution Act (FICA) taxes, including analysis by the Social Security Actuaries of the economic effect of removing the exemptions. I am Alison Siskin a Specialist in Immigration Policy at the Congressional Research Service. Importantly, I will focus on the FICA tax exemption for Social Security, not for Medicare.

There are more than 20 major nonimmigrant visa categories, and they are commonly referred to by the letter that denotes their subsection in the law.[1] Nonimmigrants are aliens admitted to the United States for a specific period of time and a specific purpose. The following nonimmigrant visa categories permit aliens to work in the United States, but exempt the aliens from paying FICA taxes:

- H-2A, temporary agricultural workers;
- F-1, foreign academic students;
- J-1, exchange visitors;
- M-1, foreign vocational students;
- Q-1, cultural exchange visitors; and
- Q-2, Irish peace process cultural exchange visitors.

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[1] Most of these nonimmigrant visa categories are defined in §101(a)(15) of the Immigration and Nationality Act (INA). These visa categories are commonly referred to by the letter and numeral that denotes their subsection in §101(a)(15), e.g., B-2 tourists, E-2 treaty investors, F-1 foreign students, H-1B temporary professional workers, J-1 cultural exchange participants, or S-4 terrorist informants.

Overview

The Social Security program provides monthly cash benefits to qualified retired and disabled workers, their dependents, and survivors. Generally, a worker must have 10 years of Social Security-covered employment to be eligible for retirement benefits (less time is required for disability and survivor benefits). Most jobs in the United States are covered under Social Security. Noncitizens (aliens) who work in Social Security-covered employment must pay Social Security payroll taxes, including those who are in the United States working temporarily and those working in the United States without authorization.[2] There are some exceptions. For example, by statute, the work of aliens under certain visa categories is not covered by Social Security.[3] The following sections examine these visa categories.

Table 1. H-2A, F-1, J-1, M-1, Q-1, Q-2 Visas Issued: FY2006

Visa Category	Number Issued
H-2A	37,149
F-1	273,870
J-1	309,951
M-1	7,227
Q-1	1,541
Q-2	80
Total	629,818

Source: Data from the Department of State, available at http://travel.state.gov/pdf/FY06AnnualReportTableXVIB.pdf, visited July 18, 2007. Data is preliminary.

Agricultural Worker (H-2A) Visas

The H-2A program allows for the temporary admission of foreign workers to the United States to perform agricultural work of a seasonal or temporary nature, provided that U.S. workers are not

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[2] For more information on Social Security benefits for noncitizens, as well as the payment rules, see CRS Report RL32004, *Social Security Benefits for Noncitizens*, by Dawn Nuschler and Alison Siskin.

[3] Another exception includes the work of aliens who are citizens of a country with which the United States has a "totalization agreement." A totalization agreement with a foreign country allows the coordination of the collection of payroll taxes and the payment of benefits under each country's Social Security system for workers who split their careers between the two countries. Totalization agreements also allow workers who divide their careers between the two countries to combine earnings credits under both systems to qualify for benefits if they lack sufficient coverage under either system. While a worker may combine earnings credits to *qualify* for benefits under one or both systems, his/her benefit is prorated to reflect only the number of years the worker paid into each system.

available.[4] An approved H-2A visa petition is generally valid for an initial period of up to one year. An alien's total period of stay as an H-2A worker may not exceed three consecutive years. H-2A employers must pay their H-2A workers and similarly employed U.S. workers the highest of the federal or applicable state minimum wage, the prevailing wage rate,[5] or the adverse effect wage rate (AEWR).[6] They also must provide workers with housing, transportation, and other benefits, including workers' compensation insurance.[7]

Employers who want to import H-2A workers must first apply to the Department of Labor (DOL) for a certification that (1) there are not sufficient U.S. workers who are qualified and available to perform the work; and (2) the employment of foreign workers will not adversely affect the wages and working conditions of U.S. workers who are similarly employed. As part of this labor certification process, employers must attempt to recruit U.S. workers and must cooperate with DOL-funded state employment service agencies (also known as state workforce agencies) in local, intrastate, and interstate recruitment efforts.

As **Table 1** shows, in FY2006, according to preliminary data, 37,149 H-2A visas were issued.[8] The H-2A program, however, remains quite small relative to total hired farm employment, which stood at about 1.1 million in 2005, according to the Department of Agriculture's National Agricultural Statistics Service.[9]

FICA Exemption for H-2A Visa Holders

Current Law. Under current law, work performed by foreign agricultural workers is not subject to FICA taxation. Section 210(a)(1) of the Social Security Act excludes from the definition of covered employment, "service performed by foreign agricultural workers lawfully admitted to the United States from the Bahamas, Jamaica, and the other British West Indies, or from any other foreign country or possession thereof, on a temporary basis to perform agricultural labor."

Legislative History. Prior to 1956, the exclusion for foreign agricultural workers applied only to services performed by agricultural workers from the Bahamas, Jamaica, and the other British West Indies under the British West Indies (BWI) program, a temporary worker program that originated in 1943 that was used mainly by farmers in the eastern United States,[10] and to workers from Mexico

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[4] The program takes its name from the section of the INA that established it — Section 101(a)(15)(H)(ii)(a). For more information on H-2A visas, see CRS Report RL32044, *Immigration: Policy Considerations Related to Guest Worker Programs*, by Andorra Bruno.

[5] The prevailing wage rate is the average wage paid to similarly employed workers in the occupation in the area of intended employment.

[6] The AEWR is an hourly wage rate set by the Department of Labor for each state or region, based upon data gathered by the Department of Agriculture in quarterly wage surveys.

[7] Required wages and benefits under the H-2A program are set forth in 20 C.F.R. §655.102.

[8] Unpublished data from the Department of State.

[9] For additional discussion, see CRS Report RL30395, *Farm Labor Shortages and Immigration Policy*, by Linda Levine.

[10] To create the BWI program, Congress needed to waive certain provisions of the Immigration and Nationality Act. P.L. 78-45, §5(g) stated that these provisions were waived "[i]n order to facilitate the

(continued...)

hired under contracts in accordance with the Agricultural Act of 1949. The FICA tax exemption for the Mexican workers was included as part of the Agricultural Act Amendments of 1951. The Senate report (S. Rept. 82-214) for the bill stated:

> Under the amendments to the Social Security Act, enacted by Congress in 1950, a limited group of "regularly employed" agricultural workers were brought in under the insurance provisions effective January 1, 1951. In order for an agricultural worker and his employer to become subject to the insurance contributions, an individual must work for one employer for at least 60 days each out of two consecutive quarters, before any of his agricultural work becomes subject to the contribution provisions of the insurance program. In most cases, it will be necessary for an individual to work 6 to 8 months for one agricultural employer before any of his agricultural work will be subject to contributions under the insurance program. Due to the relatively short period of time that Mexican contract workers work for a single employer, very few of them will meet the stringent requirements of the new law and consequently, very few of them and their employers will be subject to the social-security contributions. It is estimated that not more than 3,000 to 5,000 Mexican workers would become subject to the social-security provisions under the terms of the proposed program and, of course, if all the Mexican agricultural labor brought into this country return to Mexico within about 5 to 6 months, there would be none of the Mexican nationals who would become subject to the contribution provisions of the insurance program.

Interestingly, the minority view against the FICA tax exemption for Mexican agricultural workers in S. Rept. 82-214 stated:

> ...the exclusion of Mexican workers from the insurance program could result in the hiring of such workers in preference to American workers since their employers would have the competitive advantage of not paying social-security contributions... Since its enactment in 1935, the insurance program under the Social Security Act has covered individuals in specific types of jobs in the United States without regard to the nationality of the individual. It should be noted that the social-insurance systems in a number of foreign countries, including Mexico, do not discriminate against American nationals performing services in covered employment. This principle of nondiscrimination as between the United States nationals and the nationals of other countries has been advocated and endorsed by the International Labor Organization, by numerous representatives of social-security institutions of various countries, and by the Inter-American Committee on Social Security. A change in this policy which would establish the principle of exclusion because of nationality may eventually result in more harm than good because of the possibility of criticism arising against the United States for discrimination in the application of its social laws. Such criticism would not be in the long-run interest of the United States in world affairs.

The Social Security Amendments of 1956 (P.L. 84-880) extended the FICA tax exclusion of agricultural workers from the Bahamas, Jamaica, and the other British West Indies and the contract workers from Mexico, to foreign workers admitted to perform agricultural labor from any foreign country. According to the Senate report for the 1956 Social Security amendments (S. Rept. 84-2133), the exemption was extended because the committee had "previously recognized the undesirability of covering foreign agricultural workers who serve only temporarily in the United States... The bill

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[10] (...continued)
employment by agricultural employers in the United States of native-born residents of North America, South America, and Central America, and the islands adjacent thereto,... during continuation of hostilities in the present war..." In addition, §5(b) of the Act stated that, "[a]ny payments made by the United States or public or private agencies or employers to aliens brought into the United States under this joint resolution shall not be subject to deduction or withholding under section 143 (b) of the Internal Revenue Code."

would broaden the current exclusions so that it would apply uniformly to service performed by foreign workers admitted on a temporary basis from any foreign country to perform agricultural labor."

Student (F, M, and J) and Exchange Visitor (J and Q) Visas

The earnings of aliens on student or exchange visitor visas are exempt from FICA taxation. There are three main avenues for students from other countries to temporarily come to the United States to study, and each involves admission as a nonimmigrant. A nonimmigrant is an alien legally in the United States for a specific purpose and a temporary period of time. The three visa categories used by foreign students are F visas for academic study; M visas for vocational study; and J visas for cultural exchange.[11] Whereas the F and M visa categories are solely for foreign students, the J visa category is more varied and includes aliens in diverse cultural exchange programs such as foreign medical graduates, international visitors, and au pairs. The Q visa category is for specific types of cultural exchanges which include training and employment.

F Visa

The most common visa for foreign students is the F-1 visa. It is tailored for international students pursuing a full-time academic education. The F-1 student is generally admitted as a nonimmigrant for the period of the program of study, referred to as the duration of status.[12] The law requires that the student have a foreign residence that they have no intention of abandoning. Their spouses and children may accompany them as F-2 nonimmigrants. In FY2006, 273,870 F-1 visas were issued.[13]

To obtain an F-1 visa, prospective students also must demonstrate that they have met several criteria:

- They must be accepted by a school that has been approved by the Attorney General.[14]
- They must document that they have sufficient funds or have made other arrangements to cover all of their expenses for 12 months.[15]
- They must demonstrate that they have the scholastic preparation to pursue a full course of study for the academic level to which they wish to be admitted and must

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[11] For more information on these visa categories, see CRS Report RL31146, *Foreign Students in the United States: Policies and Legislation*, by Chad C. Haddal.

[12] Those entering as secondary school students are only admitted for one year.

[13] Department of State, *Report of the Visa Office: FY2005*, Table XVII. Available at [http://travel.state.gov/visa/about/report/report_2787.html], visited Feb. 22, 2007.

[14] Schools that wish to receive foreign students must file a petition with Department of Homeland Security (DHS) district director. The particular supporting documents for the petition depend on the nature of the petitioning school. Once a school is approved, it can continue to receive foreign students without any time limits; however, the approval may be withdrawn if DHS discovers that the school has failed to comply with the law or regulations.

[15] F, J, and M students are barred from federal financial aid. See §484(a)(5) of the Higher Education Act of 1965, as amended.

have a sufficient knowledge of English (or have made arrangements with the school for special tutoring, or study in a language the student knows).

Once in the United States on an F-1 visa, nonimmigrants are generally barred from off-campus employment. Exceptions are for extreme financial hardship that arises after arriving in the United States and for employment with an international organization. F-1 students are permitted to engage in on-campus employment if the employment does not displace a U.S. resident.[16] In addition, F-1 students are permitted to work in practical training that relates to their degree program, such as paid research and teaching assistantships. An alien on an F-1 visa who otherwise accepts employment violates the terms of the visa and is subject to removal. F-2 visa holders, who are the spouses and children of F-1 visa holders, are not allowed employment while in the United States.[17]

M Visa

Foreign students who wish to pursue a non-academic (e.g., vocational) course of study apply for an M-1 visa. This visa is the least used of the foreign student visas. Similar to the F-1 students, those seeking an M-1 visa must show that they have been accepted by an approved school, have the financial means to pay for tuition and expenses and otherwise support themselves for one year, and have the scholastic preparation and language skills appropriate for the course of study. Their spouses and children may accompany them as M-2 nonimmigrants, and are not authorized to work in the United States. As with all of the student visa categories, they must have a foreign residence they have no intention of abandoning. Those with M visas are barred from working in the United States, including in on-campus employment. In FY2006, there were 7,227 M visas issued.[18]

J Visa

Foreign students are just one of many types of aliens who may enter the United States on a J-1 visa, sometimes referred to as the Fulbright program. Others admitted under this cultural exchange visa include scholars, professors, teachers, trainees, specialists, foreign medical graduates, international visitors, au pairs, and participants in student travel/work programs. In FY2006, 309,951 J-1 visas were issued.[19]

Those seeking admission as a J-1 nonimmigrant must be participating in a cultural exchange program that the U.S. Department of State's Bureau of Educational and Cultural Affairs (BECA)[20] has designated.[21] They are admitted for the period of the program.[22] Their spouses and children may

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[16] U.S. residents include U.S. citizens, legal permanent residents, and other categories of immigrants (e.g., asylees and refugees).

[17] 8 CFR 214.2(f)(15)(i).

[18] Department of State, *Report of the Visa Office: FY2005*, Table XVII. Available at [http://travel.state.gov/visa/about/report/report_2787.html], visited Feb. 22, 2007.

[19] Ibid.

[20] This bureau was formerly the United States Information Agency (USIA).

[21] Responsible officers of the sponsoring organizations must be U.S. citizens. The programs that wish to sponsor J visas also must satisfy the following criteria: be a bona fide educational and cultural exchange program, with clearly defined purposes and objectives; have at least five exchange visitors annually; provide

(continued...)

accompany them as J-2 nonimmigrants. As with F-2 visa holders, J-2 visa holders are not authorized to be employed while they are in the United States.

As with F-1 visas, those seeking J-1 visas must have a foreign residence they have no intention of abandoning. However, many of those with J-1 visas have an additional foreign residency requirement in that they must return abroad for two years if they wish to adjust to any other nonimmigrant status or to become a legal permanent resident in the United States. This foreign residency requirement applies to J-1 nonimmigrants who meet any of the three following conditions:

- An agency of the U.S. government or their home government financed in whole or in part — directly or indirectly — their participation in the program.
- The BECA designates their home country as clearly requiring the services or skills in the field they are pursuing.
- They are coming to the United States to receive graduate medical training.

There are very few exceptions to the foreign residency requirement for J visa holders who meet any of these criteria — even J visa holders who marry U.S. citizens are required to return home for two years.[23] Although many aliens with J-1 visas are permitted to work in the programs in which they are participating, the work restrictions for foreign students with a J-1 visa are similar to those for the F visa.

As discussed above, the J visa category includes many different types of exchange programs. The regulations (22 *CFR* §62.20-§62.32) divide the J exchange programs into several categories.[24] These categories are:

- government visitors;
- international visitors;
- professors and research scholars;
- short-term scholars;
- specialists;
- college and university students (discussed above);

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[21] (...continued)
cross-cultural activities; be reciprocal whenever possible; if not sponsored by the government, have a minimum stay for participants of at least three weeks (except for those designated as "short term" scholars); provide information verifying the sponsoring program's legal status, citizenship, accreditation, and licensing; show that they are financially stable, able to meet the financial commitments of the program, and have funds for the J nonimmigrant's return airfare; ensure that the program is not to fill staff vacancies or adversely affect U.S. workers; assure that participants have accident insurance, including insurance for medical evacuations; and provide full details of the selection process, placement, evaluation, and supervision of participants. (22 CFR §514.)

[22] As with secondary students entering with F-1 visas, J-1 students in secondary school programs are only admitted for up to one year.

[23] INA §212(e) provides only a few exceptions, including cases of exceptional hardship to the spouse or child of a J-1 if that spouse or child is a U.S. citizen or permanent resident alien and in cases of persecution on the basis of race, religion, or political opinion if the alien returned home, and if it is in the national interest not to require the return.

[24] For more information, see [http://exchanges.state.gov/education/jexchanges/about.htm], visited Mar. 5, 2007.

- alien physicians;[25]
- au pairs;
- camp counselors;
- secondary students;
- summer work/travel;
- teachers, and
- trainees.

Government Visitors. This category is for exchange visitors who are sponsored by federal, state, or local government agencies. Participants in this category include editors, business and professional persons, government officials and labor leaders. The objective of this category is to develop and strengthen professional and personal ties between key foreign nationals and U.S. governmental institutions. Under this exchange program, foreign nationals recognized as influential or distinguished persons participate in observation tours, discussions, consultations, professional meetings, conferences, workshops, and travel. The participants may receive stipends or travel expenses which are paid for by the sponsoring governmental agency. The exchange program is limited to18 months.[26]

International Visitors. The International Visitor category of the J visa is for visitors sponsored by the Department of State (DOS). Under this program, foreign nationals who are recognized as potential leaders participate in observation, tours, discussions, consultation, professional meetings, conferences, workshops, and travel. DOS may pay the participants stipends or travel expenses. The program may last for no more than one year.[27]

Professors and Research Scholars. Foreign professors and research scholars are admitted under the J visa category to perform research, teach, and lecture at U.S. colleges and universities.[28] Participants in these exchange programs receive salaries from the sponsoring colleges and universities. The exchange program is limited to three years.[29]

Short-Term Scholar. Those admitted on J visas as short-term scholars include professors, research scholars, or persons with similar education or accomplishments who visit the United States to lecture, observe, consult, train, or demonstrate special skills at research institutions, museums, libraries, post-secondary accredited educational institutions, or similar types of institutions. The duration of the program is the time needed to complete the objective, up to a maximum of six months with no extensions. The institution which invited the alien may give the alien a stipend or travel expenses.

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[25] These are also known as "foreign medical graduates."

[26] 22 *CFR* §62.29.

[27] 22 *CFR* §62.28.

[28] Alien physicians in graduate medical education or training and short-term scholars are not included in this category. 22 *CFR* §62.20.

[29] A participant's program may be extended for up to six months to allow the research scholar or professor to complete a specific project or research activity. Extensions for a period longer than six months must be approved in writing by the Department of State.

Specialists. Those admitted on J visas under specialists exchange programs are experts in a field of specialized knowledge or skill, who come to the United States to observe, consult, or demonstrate special skills.[30] Examples of fields under the specialist programs include mass media communication, environmental science, youth leadership, international educational exchange, museum exhibitions, labor law, public administration, and library science. The purpose of the specialist category is to facilitate exchange among experts at scientific institutions, government agencies, museums, corporations, libraries, and similar types of institutions. Participants in these exchange programs are paid by the sponsoring entity. The maximum duration of an exchange program under this category is one year.[31]

College and University Students. To be admitted as a foreign student under the J visa category the alien's college studies or their program in the United States must be financed directly or indirectly by the U.S. Government, the government of their home country, or an international organization of which the United States is a member by treaty or statute, or be supported substantially by funding from any source other than personal or family funds. Foreign students are also eligible for J status if their program is carried out pursuant to an agreement between the U.S. Government and a foreign government, or pursuant to a written agreement between an U.S. and foreign educational institutions, an U.S. educational institution and a foreign government, or a state or local government in the United States and a foreign government.

Under the J visa category, foreign students may engage in part-time employment under certain conditions. The employment must be pursuant to the terms of a scholarship, fellowship or assistantship, and must occur on the premises of the institution at which the student is authorized to attend. Employment may be off-campus only if the student is in serious, urgent, and unforeseen economic circumstances that have arisen since acquiring exchange visitor status. The foreign student may not work more than 20 hours per week except during official school breaks, and students must continue a full course of study.[32]

Alien Physicians. Through the J visa category, foreign medical graduates may pursue graduate medical education or training at accredited schools of medicine or scientific institutions. For example, aliens in this exchange program may work as residents. To be eligible, foreign medical graduates must meet several criteria, including having adequate prior education and training, being competent in oral and written English, and passing certain qualifying exams that are specified in regulations. Program participants must provide a written statement from the government of the native country or last legal permanent residence, that provides assurances that there is a need in the country for persons with the skills which the alien is seeking to acquire. Participants must also have an agreement or contract from an accredited medical school, an affiliated hospital, or a scientific institution in the United States that provides the accredited medical education.[33] Participants in these exchange programs receive salaries from the sponsoring school of medicine or scientific institutions.

Au Pairs. The J visa Au Pair program allows foreign nationals between 18 and 26 years of age to live with a host family for 12 months, providing childcare services. Childcare is limited to no

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[30] The specialist category excludes, professors, research scholars, short term scholars, and alien physicians.

[31] 22 *CFR* §62.26.

[32] 22 CFR §62.23. For more information on this type of exchange program, see [http://exchanges.state.gov/education/jexchanges/academic/ucstudent.htm], visited Feb. 28, 2007.

[33] 22 *CFR* §62.27.

more than 10 hours per day, and to a maximum of 45 hours per week. The au pairs are compensated by the host family for their work according to the Fair Labor Standards Act as interpreted and implemented by the Department of Labor. Participants in the Au Pair program must be proficient in spoken English, and are required to complete at least six hours of academic credit or its equivalent at an accredited post-secondary educational institution. Host families are required to pay up to $500 toward the cost of the au pair's required academic course work.[34]

In addition, the J visa Au Pair program includes the EduCare component, which is for families who have school-aged children and require childcare before and after school hours. An EduCare au pair may work no more than 10 hours per day, and a maximum of 30 hours per week. EduCare au pairs receive 75% of the weekly rate paid to regular program au pairs, and must complete a minimum of 12 hours of academic credit or its equivalent during the program year. The host family is required to provide the first $1,000 toward the cost of the EduCare au pair's required academic course work.

Camp Counselors. J visa holders may also act as camp counselors, overseeing activities in a camp setting during the summer. Although the regulations note that "non-counseling" chores may be an occasional part of a camp counselor's job, program participants may not serve as "camp staff" (e.g., administrative personnel, cooks, dishwashers or janitors). Foreign university students, youth workers, and other specially qualified individuals at least 18 years of age and proficient in English may work as counselors for up to four months. J visa camp counselors receive pay and benefits from the camp commensurate with those offered to their U.S. counterparts.[35]

Secondary (High School) Students. Through the J visa high school exchange program, foreign secondary school students attend an accredited public or private secondary school in the United States as full time students for up to one year. During their stay, participants live with American host families or reside at accredited boarding schools. Participants must be between the age of 15 and 18.5 years at the time of school enrollment, or have not completed more than 11 years of primary and secondary school (excluding kindergarten). Students may not be employed, but may accept occasional work such as yard work or baby-sitting.[36]

Summer Work/Travel. Foreign post-secondary students may enter the United States on J visas to work and travel for a maximum of four months during their summer vacations. Participants receive the same pay and benefits from the employer as U.S. workers in the same or similar positions. Regulations prohibit the placement of program participants as domestics in a household, or in positions requiring them to invest their own money for inventory, such as door-to-door sales. Most participants typically work in service positions at resorts, hotels, restaurants, and amusement parks. Summer internships in businesses and other organizations (i.e., architecture, science research, graphic art/publishing and other media communication, advertising, computer software and electronics, and legal offices, etc.) are also allowed under this program.[37]

Teachers. Foreign nationals on J visas may teach in primary and secondary accredited educational institutions in the United States for up to three years. To be eligible, the participants

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[34] 22 *CFR* §62.31.

[35] 22 *CFR* §62.30.

[36] 22 *CFR* §62.25.

[37] 22 *CFR* §62.32.

must meet the qualifications for teaching in primary or secondary schools in their country of nationality or last legal residence, have a minimum of three years of teaching or related professional experience, and satisfy the standards of the state in which they will teach. They must also be of good reputation and character and proficient in English. These exchange participants receive salaries form the schools where they are employed.[38]

Trainees. The training program provides exchange visitors the opportunity to enhance their skills in their chosen career field through participation in a structured training program and to improve their knowledge of American techniques, methodologies, or expertise within their field of endeavor. These exchange visitors may be paid by the company where they are training. Such training may not exceed 18 months.

Use of the Exchange Visitor Program for ordinary employment or work purposes is strictly prohibited. Sponsors may not place trainee participants in positions which are filled or would be filled by full-time or part-time employees. In addition, the Department of State defines occupations into three categories: (1) specialty; (2) non-specialty; and (3) unskilled. Training programs are not permitted for unskilled occupations.[39] Specialty training programs are for participants who have completed a four-year degree in their field or received a recognized professional certificate.[40] Non-specialty training programs do not require participants to have completed a degree, but program participants must have at least two years of education, training or experience in the field in which they are to receive training.[41]

Q Visas

The "Q" international cultural exchange visa is for the purpose of providing practical training and employment, and sharing of the history, culture, and traditions of the participant's home country in the United States. The holders of the Q cultural exchange visa participate in a structured program, and the purpose of employment or training aspect of the Q cultural exchange program is to accomplish the cultural component.

An alien holding a Q-1 visa may stay up to 15 months and must be employed under the same wages and working conditions as U.S. workers. An alien holding a Q-2 visa must be a citizen of the United Kingdom or the Republic of Ireland who maintains a residence in one of the designated counties of those countries. Q-2 visa holders may stay up to 3 years in the United States so long as they are participants in a program that has been approved under the Irish Peace Process Cultural and Training Program Act of 1998. The State Department issued 1,621 Q-1 and Q-2 visas in FY2006.[42]

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[38] 22 *CFR* §62.24.

[39] Unskilled occupations include such occupations such as bartenders, bookkeepers, housekeepers, janitors, and hotel cleaners. For a full list of DOS defined unskilled occupations see, [http://exchanges.state.gov/education/jexchanges/private/trainee_unskilled.htm] last visited Feb. 28, 2007.

[40] 22 CFR §62.2. Examples of specialty occupations are public and business administration, architecture, engineering, and computer sciences.

[41] 22 *CFR* §62.22.

[42] Department of State, *Report of the Visa Office: FY2005,* Table XVII. Available at [http://travel.state.gov/visa/about/report/report_2787.html], visited Feb. 28, 2007.

FICA Tax Exemption Student and Exchange Visitor (F, M, J, and Q) Visas

Current Law. The Social Security Act specifically excludes the work of F, J, M, and Q visa holders from covered employment:

> Service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as amended, and which is performed to carry out the purpose specified in subparagraph (F), (J), (M), or (Q) as the case may be.[43]

If an F-1, J-1, M-1 or Q visa holder performs work which is not connected to the purpose for which they were admitted to the United States, the work is covered by Social Security, unless otherwise specifically excluded by law. Nonetheless, the very act of performing work which is not allowed under the visa category, would be a violation of the visa and subject the alien to removal from the United States.

Legislative History of the F, J, and M Visa Exemptions. The Mutual Educational and Cultural Exchange Act of 1961 (P.L. 87-256) established the J visa category and provided the FICA tax exemption for F (academic students) and J (cultural exchange) visa holders. The conference report for P.L. 87-256 (H. Rept. 87-1197) stated:

> Nonresident aliens are now subject to the 3-percent FICA, or Social Security, tax. Since they are temporarily in the United States, they scarcely have any expectation of realizing benefits from such a tax payment. Section 110(e) exempts foreign students and exchange visitors from payment of FICA tax on amounts earned in performing services to carry out the purposes for which they were admitted, such as studying, teaching, or conducting research. If they are employed for other purposes, consequent payments would not be exempt.

Notably, since 1950 earnings by U.S. citizen students employed by their schools have been exempt from FICA taxes under §210(a)(10) of the Social Security Act.[44]

In 1981, Congress divided the F visa category into two visa categories: F visas for academic students and M visas for vocational students.[45] At that time, Congress did not amend §210(a)(19) of the Social Security Act and as a result, between 1981 and 1988, F visa holders but not M visa holders were exempted from FICA taxes. In 1988, with the passage of the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647, §123), Congress extended the FICA tax exemption to M visa holders. It appears that the change was made so that the policy towards M visa holders would be consistent with that of F visa holders.

Legislative History of the Q Visa Exemption. The FICA tax exemption for Q visa holders was part of the Social Security Independence and Program Improvement Act of 1994 (P.L. 103-296). According to Congressional records, the exemption was added so that Q visa holders would receive consistent treatment with J cultural exchange visa holders. Specifically the House report noted when the Q visa category was created in 1990, that §101(a)(15)(Q) of the Immigration and Nationality Act (INA) was not expressly referenced in §210(a)(19) of the Social Security Act,

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[43] Section 210(a)(19) of the Social Security Act.

[44] This was added as part of the Social Security Amendments of 1950 (P.L. 81-734).

[45] Immigration and Nationality Act Amendments of 1981 (P.L. 97-116)

and as a result, such visa holders would not be subject to the same taxation treatment as J visa holders.[46]

Since the FICA tax exemption under §210(a)(19) was for aliens who entered the United States under §101(a)(15)(Q), when the Q-2 visa category was created in 1998, it was covered under the existing exemption provision. Congressional records were silent on whether the FICA exemption for Q-2 visa holders was intentional.

Estimate of the Financial Effects of Removing the Visa Category Exemption

Actuaries at the Social Security Administration (SSA) estimated the financial effect on the Social Security Trust Funds of covering the earnings of aliens in these visa categories. The Actuaries found that extending Social Security coverage to aliens in the currently exempt visa categories would increase payroll tax revenues. Assuming that the provision takes effect in 2008, it would increase the number of workers covered by Social Security by approximately 174,000 in 2008 (primarily J-1 visa holders).[47]

The Actuaries estimate that, on average, each newly covered visa worker would have earnings of approximately $26,000 subject to the FICA tax in 2008. Therefore, the provision increases the wages subject to the Social Security payroll tax and increases payroll tax revenue by approximately $521 million in 2008. The annual tax revenue would increase to $834 million by 2017. Because these workers are not anticipated to be employed in the United States for the 10 years generally required to qualify for Social Security benefits, the Actuaries estimate that the increased costs to the Trust Funds from increased benefit payments to these workers would be small. Over a 10 year period, 2008-2017, the proposal would increase Social Security payroll tax revenues by $6.9 billion.

Thank you again for the opportunity to speak here today, and I look forward to your questions.

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[46] H. Rept 103-506, p. 77.

[47] In addition, the Actuaries assumed that most F-1 visa holders would still be exempt from FICA taxation on their wages, due to the existing exemption for work performed by students at their college or university.

COMMUNICATION

Statement of the American Farm Bureau Federation

TO THE UNITED STATES SENATE COMMITTEE ON FINANCE

RELATING TO THE JULY 24, 2007 HEARING

OVERSIGHT OF GOVERNMENT TAX POLICY IN FARM COUNTRY

600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024 | p. 202.406.3600 | f. 202.406.3606 | www.fb.org

The American Farm Bureau Federation appreciates the opportunity to comment on tax issues impacting farm and ranch families and the agricultural businesses that they operate.

The two most pressing tax issues facing our nation's farmers and ranchers remain the devastating impact of estate taxes and the unfairness of the Alternative Minimum Tax (AMT). Farm Bureau urges Congress to act swiftly to end the burden of estate taxes and the unfairness of the AMT.

Pending energy tax legislation has the potential to bolster the agriculture economy through tax incentives for renewable fuels like ethanol, cellulosic ethanol, biodiesel, renewable diesel, and wind energy. Producing more renewable energy at home will not only help family farmers and businesses in the short-term, but will also spur major new long-term investments that will allow economies of scale to bring down the cost of domestic clean energy supplies while creating quality, high-technology jobs. Farm Bureau supports prompt passage of the Energy Advancement and Investment Act of 2007.

Farm Bureau supports passage of legislation to reverse existing tax policies that wrongly cause farmers and ranchers to pay self-employment taxes on Conservation Reserve Program payments and will force them to begin paying the new 3-percent withholding tax on USDA payments beginning in 2011.

Lastly, Farm Bureau supports a series of tax proposals that will improve net farm income, benefit the environment and increase donations of food to people in need.

Farm Bureau supports the immediate and permanent elimination of death taxes. Full unlimited stepped-up basis at death must be included in any estate tax reform. Until repeal can be accomplished, Farm Bureau supports increasing the exemption to $10 million per person and indexing the exemption to inflation. The annual federal gift tax exemption should be increased to $20,000 and be indexed for inflation. Heirs should have the choice of valuing land at either fair market value or current use value without limitation, and there should be no estate tax on land that remains in agricultural production.

More than 2 million farms dot America's rural landscape. Individuals, family partnerships and family corporations own 99 percent of them. Family farms produce about 94 percent of U.S. agricultural products sold. Death taxes can destroy family-owned farms and ranches when the tax, which can be as high as 45 percent, forces farmers and ranchers to sell land, buildings or equipment needed to operate their businesses. The burden is so great that in 1999 to 2000, the average estate tax payment was the equivalent of one-and-a-half to two years of net farm income.

Farm and ranch estates face heavier, potentially more disruptive death tax burdens than other estates. Roughly twice the number of farm estates paid federal death taxes compared to other estates in the late 1990s. Moreover, the average farm death tax is also

larger than the tax paid by most other estates. When farms and ranches disappear, the rural communities and businesses they support are also adversely impacted. Farmland located close to urban centers is often lost forever to development when death taxes force farm families out of business. These problems can only be resolved through permanent estate tax reform.

Farm Bureau supports S. 55 to repeal of the Alternative Minimum Tax (AMT).

Farm Bureau supports repeal of the AMT since it no longer promotes tax equity. Because of the way the tax is calculated, the impact on farmers and ranchers is greater than on the public at large. Operating loss deductions, deductions for state and local taxes and favorable capital gains tax treatment were enacted by Congress for sound policy reasons. To deny them under the AMT, and thereby add to the farm and ranch tax burden, creates an unintended but real financial strain on agricultural producers. At the very least, the household income threshold and exemption amount should be increased and indexed for inflation. As a matter of fairness, changes should be made to allow farmers to take full advantage of the deductions for operating loss and for state and local taxes. Alterations also are needed so that capital-intensive businesses like farming are not disadvantaged by the tax.

Farm Bureau supports S. 1155 to ensure that USDA Conservation Reserve Program (CRP) payments are not subject to self-employment taxes.

USDA makes CRP payments to land owners who sign rental agreements and refrain from farming the property in order to conserve and improve the environmental resources of that land. Recent, but conflicting, court decisions have allowed the IRS to collect SE taxes on CRP rental payments when the landowner is actively engaged in farming. The IRS is now proposing to expand the collection of SE taxes to include CRP rent paid to non-farm landlords.

SE taxes should not be paid on CRP payments because they clearly constitute "rent" that by law should not be subject to SE taxation. Farmers, as part of their CRP contract, agree not to farm the land and obligate themselves to provide minimal maintenance services. These required maintenance activities are not services to the government, but rather activities needed to make the property usable for conservation purposes.

It is wrong for the IRS to single out farmers and ranchers to pay the self-employment tax on CRP rental receipts when property owners in analogous situations do not pay the tax. For example, a building owner rents space to a tenant for a fee and provides basic upkeep to repair normal wear and tear and maintain the property. The building owner does not pay SE taxes on rental income; therefore, CRP rent should be treated the same.

Farm Bureau supports S. 700 to provide tax incentives that encourage farmers and ranchers to increase efforts to safeguard plant and animal species.

Voluntary cooperation between landowners and government is the surest way to achieve effective conservation with minimum disruptions to existing land uses. Under such

programs, private landowners voluntarily participate in the Endangered Species Recovery Program by entering into conservation easements or management agreements in which they agree to take or refrain from taking certain actions in order to enhance the recovery of listed species. If accepted, the owners become eligible for tax credits depending on their level of participation.

With private lands providing habitat for 80 percent of listed species, Farm Bureau is convinced that cooperation with private landowners is essential if the Endangered Species Act (ESA) is to achieve its goal of recovering species. The vast majority of landowners want to enjoy listed species on their property but are often stymied by restrictions on the use of their land by ESA regulations. By encouraging the improvement of species habitat, tax incentives provide an excellent way to help landowners take an active part in species recovery.

Farm Bureau supports S. 469 to extend tax deductions for voluntarily donated conservation easements as a way to preserve farmland, open space and habitat.

Voluntary conservation easements are an important tool for land conservation. When farmers and ranchers voluntarily donate conservation easements, they protect farmland for future generations from development by giving up development rights while retaining ownership and management of the land. The Pension Protection Act of 2006 provides an enhanced deduction of up to 100 percent of a farmer or rancher's income with a 15 year carry forward. Unless Congress acts, the deduction will be limited to 30 percent of a farmer's income and the time that the deduction can be carried forward will only be five years beginning in 2008.

Tax deductions for donated conservation easements provide farmers and ranchers an economic benefit for preserving farmland, but the separation of development rights from property reduces land equity. The enhanced 100 percent deduction of income makes land conservation financially possible for farmers and ranchers who often rely on the equity in their land for income during retirement years. The 15-year carry forward allows modest-income farmers and ranchers to receive a benefit for donating development rights to their land. These enhanced benefits need to be extended to maximize the amount of land being protected by voluntary conservation easements.

Farm Bureau supports S. 689 to extend and expand tax incentives to increase donations of food to charitable organizations that feed people in need.

Despite the wealth of our country, affordable food prices and ongoing government food assistance programs, some people still have difficulty obtaining food for a proper diet. Some farmers and ranchers already donate gleaned food to charitable organizations that feed the hungry. Many more would do so if they were able to bear the costs of harvesting, processing and transportation.

Underlying tax law allows businesses operating as C Corporations to take a deduction, the value of which is determined using the tax basis of the donated food. Section 1202 of

the Pension Protection Act of 2006 expands those eligible for the deduction to include all businesses regardless of how they are organized, through 2007. The expanded deduction for donated food should be permanently extended.

In addition, Farm Bureau recommends a change to allow farmers and ranchers who use cash method accounting to also benefit from tax incentives that encourage food donations. Most farms and ranches in our country are operated as sole proprietors or partnerships, many of which use cash basis accounting. Using tax basis to determine the value of the deduction excludes cash method producers and consequently reduces the potential for donations of food to food banks and other feeding organizations.

Farm Bureau believes that farm business machinery and equipment depreciation should be shortened to five years and supports S. 1621.

Farming and ranching is an equipment-heavy industry with nearly $100 billion of stock in use during any given year. The share of farm assets attributable to machinery and farm-use motor vehicles makes up 7 percent of total assets owned by farmers and ranchers. Ideally, the allowed number of years to depreciate a piece of business machinery or equipment should match the period of debt service so that the tax benefits can be used to finance payments.

USDA's Farm Service Agency surveys show that, on average, farmers and ranchers finance business equipment and machinery for five years. A change in depreciable life from seven to five years would align depreciation and debt service and increase farm income by $800 million in a typical year. This change would not only help farmers and ranchers cover their debt service, but it also would help them replace worn-out machinery.

Farm Bureau supports an increase in thresholds for paying self-employment taxes using the farm optional method so that all farmers and ranchers can qualify for Social Security disability benefits.

Social Security payments can be a significant part of retirement income for older farmers and ranchers and to working farmers and ranchers, especially for those with young dependents, who depend on survivors and disability benefits. But qualifying for Social Security benefits can be difficult for self-employed farmers and ranchers because they do not always have a steady income stream. When there are no earnings, no Social Security taxes are paid and benefits are denied.

Congress provided a way for farmers and ranchers to voluntarily pay Social Security taxes in order to earn quarters so that they can receive Social Security benefits. It is called the farm option method. However, the payment thresholds are outdated and no longer allow farmers and ranchers to earn four quarters of credit per year. This could mean, for example, that a disabled farmer and his family would be denied disability benefits because the outdated thresholds prevented them from maintaining their eligibility.

Farm Bureau supports S. 777 to repeal of the 3-percent withholding tax on government payments for goods and services that will begin in 2011.

The Tax Increase Prevention and Reconciliation Act of 2005 imposes a 3-percent withholding tax on payments for property and services made by the government, beginning in 2011. Taxes withheld are credited against the taxpayer's income tax liability for the year or are refunded if taxes are not owed.

The withholding tax will apply to many USDA payments and will hurt farmers and ranchers. Farm Bureau supports its repeal for the following reasons:

- Farm profitability and tax liability fluctuate greatly from year to year due to weather and markets, but taxes are withheld regardless. For agricultural operations that end the year without owing taxes, the withholding amounts to an interest-free loan to the government.

- The tax is withheld on gross government payments while taxes are due on net income. This means that the amount of money withheld could be a substantial portion of the entire net income of a farm or ranch business, thereby creating significant cash flow problems.

- Farm and ranch inputs often are purchased months before a commodity is sold. Reducing farm revenue by 3 percent of government payments could create cash flow problems and make it harder for farmers to purchase the supplies they need.

- Withholding taxes on emergency and disaster programs reduces the amount of assistance provided to farms and ranches affected by floods, droughts, freezes and other natural disasters.