



# Taxation of USDA Discrimination Awards from the Inflation Reduction Act

---

June 24, 2024

JC Hobbs, Oklahoma State University

Guido van der Hoeven, NC State University, Emeritus

# Rural Tax Education

---

RuralTax.org



- Website hosted by Utah State University
- Material developed, managed, and owned by the **National Farm Income Tax Committee**
- Informational Material on Ag, Timber, and Rural Tax topics include but not limited to:
  - Disaster/Weather Losses
  - Treatment of Government Payments
  - Farm Losses and Hobby Rules
  - Self-Employment Taxes
  - Estate and Gift Taxes
  - Like Kind Exchanges
  - Depreciation
  - Etc...



# Disclaimer

---

This material is based upon work supported by the U.S. Department of Agriculture, under agreement number FSA21CPT0012032. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Agriculture. In addition, any reference to specific brands or types of products or services does not constitute or imply an endorsement by the U.S. Department of Agriculture for those products or services. USDA is an equal opportunity provider, employer, and lender. Rural Tax Education is part of the National Farm Income Tax Extension Committee. In their programs and activities, the land-grant universities involved in this project do not discriminate based on race, color, religion, sex, national origin, age, genetic information, sexual orientation or gender identity/expression, disability, status as a protected veteran, or any other status protected by University policy or local, state, or federal law.

# Program Agenda

---

RuralTax.org

- Provide background for the awards
- Present the provisions of the program
- Discuss the types of recipients
- Examples illustrate the awards and how these might be reported and taxed
- Provide guidance (with caution) to assist recipients
- Answer questions to the best of our ability

*Addition information is provided in the fact sheet:  
“Taxability of USDA Discrimination Awards Resulting  
from the Inflation Reduction Act of 2022”*

# Developments: Caution

---

**CAUTION:** Recipients of DFAP awards are strongly encouraged to seek tax advice from competent advisors. Taxability is dependent on facts and circumstances of the individual cases, especially regarding the DFAP award being subject to self-employment tax. For more information about how to find a competent tax advisor, please go here: [<https://www.farmers.gov/your-business/taxes#training>]

New guidance may be forthcoming, be alert to any new developments regarding IRA DFAP awards.

# Introduction

---

- IRA included a provision authorizing USDA to address past discrimination of farm lending programs prior to 2021
- Payment of financial assistance through USDA's Discrimination Financial Assistance Program (DFAP)
- The award is taxable as ordinary income
- Depending upon the facts and circumstances, it is possible that the award is subject to self-employment tax as well
- Application period closed January 17, 2024.

# Background

---

- Section 22007 authorized USDA to address past discrimination
- Discrimination defined as:
  - Treating people differently for illegitimate reasons
  - Failure to provide appropriate assistance
  - Delay in loan processing or loan servicing
  - Denial of a loan or loan servicing
  - Prevention from applying for a loan or loan servicing
  - Adverse loan terms
  - Unduly onerous supervision of loan requirements

Where these were due to the customer's race, color, national origin or ethnicity, sex, sexual orientation, gender identity, religion, age, marital status, or disability, or in reprisal/retaliation for prior civil rights activity.

- DFAP created to generate and accept discrimination applications

# Background

---

- Potential responses in the application
  - Applicant was the farm loan borrower or an intended borrower.
  - Applicant had a co-borrower (e.g., spouse).
  - Applicant participated in an entity that farmed (e.g., partnership).

Additionally, some DFAP participants have or had farming or ranching operations on land owned, leased or a combination of the two, and others intended to have such operations but were unable to do so due to discrimination at the start of the intended farming business.
- Review process uses two independent teams to help with application review
- Once approved and payments issued, the next step the recipient will encounter is the receipt of a Form 1099-MISC from USDA



# Tax Issues – IRS FAQs

---

- IRS issued a fact sheet (FS-2024-05) regarding taxing DFAP
- The FAQ guidance covers 3 points:
  1. The payment (award) is includible in gross income under section 61 of the Internal Revenue Code.
  2. Attorney fees involving a claim of unlawful discrimination may be deducted “above-the-line” limited to the amount of any payment (award) received. It is an adjustment to income on Schedule 1 (Form 1040), Part II, Line 24h.
  3. Payment (award) may be subject to self-employment tax (SE Tax) depending on the particular facts and circumstances. SE Tax consists of Social Security and Medicare taxes primarily for individuals who work for themselves so they may receive Social Security and Medicare benefits later. SE Tax is imposed on net earnings from self-employment, which generally means the gross income from a trade or business, less certain business deductions.

# DFAP Payments & Tax Reporting

---

- Examples are used to illustrate tax reporting under various individual situations:
  1. Received the award while still in the business of farming
  2. Received the award after retiring from farming
  3. Received the award but never was in the business of farming
  4. Received the award as a business partner or member of an LLC
  5. Received the award as a shareholder/employee of a Sub-S corporation
  6. Received the award but hired an attorney and deducting legal fees

# DFAP Payments & Tax Reporting

---

- It will be important to consult with a tax professional to:
  1. Determine how much of the award to set aside for paying the tax owed
  2. Assist with proper reporting of the award and on the tax return
- Amounts used in the examples are for illustrative purposes only!

**CAUTION:** Recipients of DFAP awards are strongly encouraged to seek tax advice from competent advisors. Taxability is dependent on facts and circumstances of the individual cases, especially regarding the DFAP award being subject to self-employment tax.

# Example 1. Still Farming

---

- Jose operates a truck farm, growing and selling vegetables
- Applied for a \$50,000 FSA loan in 2010
- Denied the loan due to discrimination
- He received alternative financing and continued to farm
- Applied for and received a DFAP award of \$15,000.
- Jose received a Form 1099-MISC with \$15,000 reported in Box 3, Other Income
- Jose reports the award on his Schedule F, Form 1040, Lines 4a and 4b

# Example 1. Still Farming

**SCHEDULE F  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

## Profit or Loss From Farming

Attach to Form 1040, 1040-SR, 1040-SS, 1040-NR, 1041, or 1065.  
Go to [www.irs.gov/ScheduleF](http://www.irs.gov/ScheduleF) for instructions and the latest information.

OMB No. 1545-0074

**2023**  
Attachment  
Sequence No. **14**

Name of proprietor JOSE DFAP payment recipient				Social security number (SSN) JOSE SSN			
A Principal crop or activity Vegetables		B Enter code from Part IV 1 1 1 2 1 0		C Accounting method: <input type="checkbox"/> Cash <input type="checkbox"/> Accrual		D Employer ID number (EIN) (see instr.)	
E Did you "materially participate" in the operation of this business during 2023? If "No," see instructions for limit on passive losses				<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			
F Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions				<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			
G If "Yes," did you or will you file required Form(s) 1099?				<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			

**Part I Farm Income – Cash Method.** Complete Parts I and II. (Accrual method. Complete Parts II and III, and Part I, line 9.)

1a	Sales of purchased livestock and other resale items (see instructions)	1a		
b	Cost or other basis of purchased livestock or other items reported on line 1a	1b		
c	Subtract line 1b from line 1a	1c		
2	Sales of livestock, produce, grains, and other products you raised	2		
3a	Cooperative distributions (Form(s) 1099-PATR)	3a		3b Taxable amount
4a	Agricultural program payments (see instructions)	4a	15,000	4b Taxable amount
				15,000

# Example 1. Still Farming

---

- Jose is still farming, therefore the award is also subject to self-employment tax
- His marginal tax rate is estimated to be 32.3 percent
  - 12 percent federal income tax, plus
  - 15.3 percent self-employment tax, plus
  - 5 percent state income, equals
  - 32.3 percent
- His estimated tax liability is \$4,845 ( $\$15,000 \times 32.3$  percent)
- Jose should consult his tax professional

# Example 2. Retired from Farming

---

- Susie operated a dairy, selling milk and artisan cheeses
- Applied for a \$100,000 FSA loan in 2015
- Denied the loan due to discrimination
- She liquidated the herd and equipment in 2018 and retired
- Applied for and received a DFAP award of \$60,000.
- Susie received a Form 1099-MISC with \$60,000 reported in Box 3, Other Income
- Since she retired from farming, it could be argued that there is not a nexus to the past farming business
- Her award is taxable but not subject to SE Tax
- She reports the award on Schedule 1 (Form 1040), Part I, Line 8z

# Example 2. Retired from Farming

**SCHEDULE 1**  
(Form 1040)

Department of the Treasury  
Internal Revenue Service

## Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2023**

Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Susie - retired from dairy farming - DFAP recipient

Your social security number

Susie SSN

**u** Wages earned while incarcerated

**8u**

**z** Other income. List type and amount: 1099 MISC - DFAP payment

**8z**

60,000

**9** Total other income. Add lines 8a through 8z

**9**

60,000

**10** Combine lines 1 through 7 and 9. This is your **additional income**. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8

**10**

60,000

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2023



# Example 2. Retired from Farming

---

- Since Susie is retired from farming, the award is arguably not subject to self-employment tax
- Her marginal tax rate is estimated to be 17 percent
  - 12 percent federal income tax, plus
  - 5 percent state income, equals
  - 17 percent
- Her estimated tax liability is \$10,200 ( $\$60,000 \times 17$  percent)
- Susie should consult her tax professional

# Example 3. Intended to Farm

---

- Running Fox sought a beginning farmer loan upon graduation
- Applied for a \$150,000 loan to purchase equipment and pay for operating expenses
- He was denied the loan in 1996
- Applied for and received a DFAP award of \$30,000.
- Running Fox received a Form 1099-MISC with \$30,000 reported in Box 3, Other Income
- Since he never was in the business of farming, the award is taxable but not subject to SE Tax
- He reports the award on Schedule 1 (Form 1040), Part I, Line 8z

# Example 3. Intended to Farm

**SCHEDULE 1**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service

## Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2023**

Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Runnig Fox - intended farmer- DFAP payment recipient

Your social security number

SSN

### Part I Additional Income

a	nongovernmental section 457 plan . . . . .	8t		
u	Wages earned while incarcerated . . . . .	8u		
z	Other income. List type and amount: 1099 MISC - DFAP payment			
		8z	30,000	
9	Total other income. Add lines 8a through 8z . . . . .	9		30,000
10	Combine lines 1 through 7 and 9. This is your <b>additional income</b> . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8 . . . . .	10		30,000

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2023

# Example 3. Intended to Farm

---

- Since Running Fox never started a farm business, the award is subject to income tax (not SE tax)
- His marginal tax rate is estimated to be 27 percent
  - 22 percent federal income tax, plus
  - 5 percent state income, equals
  - 27 percent
- His estimated tax liability is \$8,100 ( $\$30,000 \times 27$  percent)
- Running Fox should consult his tax professional

# CAUTION: IRS Matching Program

---

- Running Fox receives a Form MISC in the amount of \$30,000
- The IRS matching program may “look” for this income to be reported on Schedule F, Line 4
- Because Running Fox never farmed, this income should not be subject to self-employment tax
- Reporting the award on Line 8z of Schedule 1 is the proper line to use
- However, a CP-2000 letter might be issued by the IRS to match this award to the income reported on his tax return
- A follow-up letter may be necessary to explain where Running Fox did indeed report the DFAP award on his tax return

# Example 4. Partner or Member of LLC

---

- Ruby is a member of a farming partnership with her 3 sisters
- The 4 partners have equal ownership of 4-S Farms
- 4-S Farms applied for a land ownership loan and was denied
- Because discrimination occurred at the partnership level (not at the individual level), each of the partners made an application and each received a \$50,000 award

# Example 4. Partner or Member of LLC

---

- If the partnership continued in business, nexus generally exists to the farm, thus each partner individually files a Schedule F to report the DFAP award, subject to ordinary and SE tax similar to Example 1.
- If Ruby or one of the other partners retired from 4-S Farms, it could be argued that there is no nexus of the award to the retired partner(s) of 4-S Farms, however, this is a facts and circumstances issue, see the following caution.
- If this is true, the retired individual would report her DFAP payment of \$50,000 on Schedule 1 (Form 1040), Part I, Line 8z; not subject to SE tax.

# Example 4. Partner or LLC Member

**SCHEDULE 1**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service

## Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2023**

Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Ruby - partner - DFAP payment recipient

Your social security number

Ruby's SSN

### Part I Additional Income

<b>u</b>	Wages earned while incarcerated . . . . .	<b>8u</b>		
<b>z</b>	Other income. List type and amount: 1099 MISC - DFAP payment			
		<b>8z</b>	50,000	
<b>9</b>	Total other income. Add lines 8a through 8z . . . . .	<b>9</b>		50,000
<b>10</b>	Combine lines 1 through 7 and 9. This is your <b>additional income</b> . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8 . . . . .	<b>10</b>		50,000

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2023



# Example 4. Partner or LLC Member

---

- Since Ruby is a retired partner in 4-S Farms, the award is arguably only subject to ordinary income tax
- Her marginal tax rate is estimated to be 27 percent
  - 22 percent federal income tax, plus
  - 5 percent state income, equals
  - 27 percent
- Her estimated tax liability is \$13,500 ( $\$50,000 \times 27$  percent)
- Ruby is strongly urged to consult her tax professional
  
- When reported on Schedule F, the marginal tax rate is 42.3% ( $27 + 15.3$ ) and the tax liability is \$21,150, reported on Line 8.

# CAUTION: Partners and LLC Members

---

**CAUTION:** Recipients of DFAP awards who are partners (partnership) or members (LLC) are strongly encouraged to seek tax advice from competent advisors. Taxability is dependent on facts and circumstances of the individual cases, especially regarding the question of nexus to the entity which was subject to discrimination and thus may be subject to self-employment tax.

# Example 5. S-Corp Shareholder/Employee

---

- The same facts as in Example 4 but the entity is a Sub-S Corporation
- Ruby and her 3 sisters have equal ownership shares in 4-S Farms, Inc.
- Because discrimination occurred at the corporate level (not at the individual level), each of the shareholders made an application and each received a \$50,000 award
- It could be argued that the award is a distribution (not rents nor wages), not subject to SE tax
- Ruby reports her DFAP award of \$50,000 on Schedule 1 (Form 1040), Part I, Line 8z

# Example 5. S-Corp Shareholder/Employee

**SCHEDULE 1**  
(Form 1040)

Department of the Treasury  
Internal Revenue Service

## Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2023**

Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR	Your social security number
RUBY - USDA Discrimination Payment (Sub-S entity example)	SSN

### Part I Additional Income

<b>u</b> Wages earned while incarcerated . . . . .	<b>8u</b>		
<b>z</b> Other income. List type and amount: <u>USDA Discrimination Payments</u>	<b>8z</b>	50,000	
<b>9</b> Total other income. Add lines 8a through 8z . . . . .	<b>9</b>		50,000

# Example 5. S-Corp Shareholder/Employee

---

- Since Ruby is a shareholder in 4-S Farms, Inc. the award (treated as a distribution) is only subject to ordinary income tax
- Her marginal tax rate is estimated to be 27 percent
  - 22 percent federal income tax, plus
  - 5 percent state income, equals
  - 27 percent
- Her estimated tax liability is \$13,500 ( $\$50,000 \times 27$  percent)
- Ruby is urged to consult her tax professional

# Example 6. Deducting Attorney Fees

---

- George operated a crop farm in Georgia
- He applied for a \$300,000 loan to expand the farm operation
- He was discriminated against and denied the loan
- He became disabled and retired from farming many years ago
- George hired an attorney to help him complete the discrimination application (the attorney charged a 25 percent contingency fee)
- His application was accepted, and George received a \$45,000 award

# Example 6. Deducting Attorney Fees

---

- George reports the award received on Schedule 1 (Form 1040), Part I, Line 8z
- The attorney fee was 25 percent of the \$45,000 award or \$11,250
- George then reports the attorney fee as a deduction on Schedule 1 (Form 1040), Part II, Line 24h
- George will report both amounts on the appropriate lines of his Form 1040
- For additional information concerning the proper deduction of attorney fees, refer to the IRS Fact Sheet's FAQ question 2

# Example 6. Deducting Attorney Fees

**SCHEDULE 1**  
**(Form 1040)**  
  
Department of the Treasury  
Internal Revenue Service

## Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2023**

Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

George - DFAP payment recipient - attorney fees deducted

Your social security number

George SSN

### Part I Additional Income

<b>u</b> Wages earned while incarcerated . . . . .	<b>8u</b>		
<b>z</b> Other income. List type and amount: 1099 MISC - DFAP payment			
	<b>8z</b>	45,000	
<b>9</b> Total other income. Add lines 8a through 8z . . . . .	<b>9</b>		45,000
<b>10</b> Combine lines 1 through 7 and 9. This is your <b>additional income</b> . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8 . . . . .	<b>10</b>		45,000

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2023



# Example 6. Deducting Attorney Fees

Schedule 1 (Form 1040) 2023

Page 2

## Part II Adjustments to Income

h	Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions) . . . . .	24h	11,250	
i	Attorney fees and court costs you paid in connection with an award from the IRS for information you provided that helped the IRS detect tax law violations . . . . .	24i		
j	Housing deduction from Form 2555 . . . . .	24j		
k	Excess deductions of section 67(e) expenses from Schedule K-1 (Form 1041) . . . . .	24k		
z	Other adjustments. List type and amount: <input type="text"/>	24z		
25	Total other adjustments. Add lines 24a through 24z . . . . .	25	11,250	
26	Add lines 11 through 23 and 25. These are your <b>adjustments to income</b> . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 10 . . . . .	26	11,250	

Schedule 1 (Form 1040) 2023

# Summary and Conclusion

---

- The DFAP award is taxable income
- The award may be subject to SE Tax based upon the recipient's facts and circumstances
- Attorney fees paid are deductible
- Consult a tax professional for proper reporting of the award on the tax return
- Be sure to refer to the website, as any additional information and IRS clarification becomes available

# Tax References and Resources

---

IRS Publication 225, The Farmer's Tax Guide

Rev. Rul. 91-19, 1991-1 CB 186, IRC Sec(s). 1402

Treas. Reg. Treas Reg. 1.1402(a)-1(c)

[https://www.irs.gov/irm/part21/irm\\_21-006-004r](https://www.irs.gov/irm/part21/irm_21-006-004r)

*Pigford v. Glickman, Pigford II* (Black Farmers Discrimination Litigation)

*Jackson v. Commissioner* 108 TC 130, Code Sec(s) 1401; 1402.

*Milligan v Commissioner* TCM 1992-655

*Newberry v Commissioner* 76TC 441, 444

# Tax Educational Resources

---

<https://www.farmers.gov/your-business/taxes#training>

## **Finding a tax professional**

<https://www.youtube.com/watch?v=j6t7Dti3WRs>

<https://extension.usu.edu/ruraltax/tax-topics/how-to-choose-a-tax-professional>

# Future Developments: Caution

---

**CAUTION:** Recipients of DFAP awards who are partners (partnership) or members (LLC) are strongly encouraged to seek tax advice from competent advisors. Taxability is dependent on facts and circumstances of the individual cases, especially regarding the question of nexus to the entity which was subject to discrimination and thus may be subject to self-employment tax.

New guidance may be forthcoming, be alert to any new developments regarding IRA DFAP payments.

# Thank you for Attending!!

---

What questions might you have?

For any follow-up questions contact:

[janet.wright@usda.gov](mailto:janet.wright@usda.gov)

