Statement of the
American Farm Bureau Federation

SUBMITTED FOR THE HEARING RECORD
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

“HOW TAX REFORM WILL GROW OUR ECONOMY AND CREATE JOBS”

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The American Farm Bureau Federation is the country's largest general farm organization, with nearly 6 million member families and representing nearly every type of crop and livestock production across all 50 states and Puerto Rico. Our members grow and produce the food, fiber and fuel that propel our nation's economy as well as putting food on our tables. According to USDA, 11 percent of U.S. employment comes from the agriculture and food industry, accounting for 21 million jobs of which about 18 million are off-the-farm positions.

Federal tax policy affects the economic behavior and well-being of farm households as well as the management and profitability of farm and ranch businesses. Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We appreciate the opportunity to file this statement explaining the importance of tax reform and highlighting tax code provisions important to the long-term financial success of farm and ranch businesses.

Farms and ranches operate in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncertain weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. Farmers and ranchers need a tax code that recognizes the financial challenges that impact agricultural producers. They want a simpler more transparent tax code that doesn't make the challenging task of running a farm or ranch business more difficult than it already is.

Farm Bureau supports tax laws that help the family farms and ranches that grow America's food and fiber, often for rates of return that are modest compared to other business opportunities. What is needed is tax reform that supports high-risk, high-input, capital-intensive businesses like farms and ranches that predominantly operate as sole proprietors and pass-through entities. We believe that tax reform should be equitable and designed to encourage private initiative and domestic economic growth.

Farm Bureau commends the Committee on Ways and Means for moving forward with comprehensive tax reform designed to spur growth of our nation's economy. Many of the provisions of the tax reform blueprint will be beneficial to farmers, including reduced income tax rates, reduced capital gains taxes, immediate expensing for all business inputs except land, and the elimination of the estate tax. The proposed loss of the deduction for business interest expense and the deduction for state and local taxes, however, is a cause for concern. The blueprint can be improved by guaranteeing the continuation of stepped-up basis, preserving cash accounting and maintaining like-kind exchanges.

The statement that follows focuses on and provides additional commentary on the tax reform issues most important to farmers and ranchers.

COMPRHENSIVE TAX REFORM WILL BOOST FARM AND RANCH BUSINESSES

Any tax reform proposal considered by Congress must be comprehensive and include individual as well as corporate reform and rate reduction. By far, the most common form of farm ownership is as a sole-proprietor. In total, farms and ranches operated as individuals, partners and S corporation shareholders constitute about 97 percent of our nation's 2 million farms and ranches and about 85 percent of total agricultural production. Because many business deductions and credits are used by both corporate and pass-through businesses, their elimination without substantial rate reduction for all business entities could result in a tax increase for the vast majority of farmers and ranchers.

LOWER EFFECTIVE TAX RATES WILL BENEFIT FARM AND RANCH BUSINESSES

Farm Bureau supports reducing tax rates and views this as the most important goal of tax reform. While lower tax rates are important, the critical feature for farmers and ranchers is the effective tax rate paid by farm and ranch businesses. Tax reform that lowers rates by expanding the base should not increase the overall tax burden (combined income and self-employment taxes) of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions for all business entities and for all rate brackets could result in a tax increase for agriculture.

Farming and ranching is a cyclical business. A period of prosperity can be followed by one or more years of low prices, poor yields or even a weather disaster. Without the opportunity to even out income over time, farmers and ranchers will pay more than comparable non-cyclical businesses. Tax code provisions like income averaging allow farmers and ranchers to pay taxes at an effective rate equivalent to a business with the same aggregate but steady revenue stream. Farm savings accounts would accomplish the same object plus allow a famer or rancher to reserve income in a dedicated savings account for withdrawal during a poor financial year. Installment sales of land benefits both buyers and sellers by providing sellers with an even income flow and buyers with the ability to make payments over time.

ACCELERATED COST RECOVERY HELPS FARMERS REMAIN EFFICIENT

Farmers and ranchers need to be able to match income with expenses in order to manage their businesses through challenging financial times. Expensing allows farm and ranch business to recover the cost of business investments in the year a purchase is made. In addition to Sect. 179 small business expensing, the tax code also provides immediate cost recovery through bonus depreciation and through long-standing provisions that allow for the expensing of soil and water conservation expenditures, expensing of the costs of raising dairy and breeding cattle and for the cost of fertilizer and soil conditioners such as lime. Farm Bureau supports the expansion of immediate expensing.

Because production agriculture has high input costs, Farm Bureau places a high value on the immediate write-off of all equipment, production supplies and pre-productive costs. While Sect. 179 does provide full expensing for most small and mid-size farms, USDA reports that almost a quarter of the large farms that account for nearly half of all agricultural production made investments exceeding the expensing limit in 2015. Thus, an expansion of immediate expensing has the potential to change the investment behavior of farms responsible for a significant amount of agriculture production.

When farmers are not allowed immediate expensing they must capitalize purchases and deduct the expense over the life of the property. Accelerated deductions reduce taxes in the purchase year, providing readily available funds for upgrading equipment, to replace livestock, to buy production supplies for the next season and for farmers to expand their businesses. This is a not only a benefit to production agriculture; a journal Agricultural Finance Review study found that for every $1,000 increase to the Section 179 expensing amount, farms that had been previously limited by the expensing amount made an incremental capital investment of between $320 and $1,110.

CASH ACCOUNTING HELPS FARM AND RANCH BUSINESSES TO CASH FLOW

Cash accounting is the preferred method of accounting for farmers and ranchers because it allows them to match income with expenses and aids in tax planning. Farm Bureau supports the continuation of cash accounting.

Cash accounting allows farmers and ranchers to improve cash flow by recognizing income when it is received and recording expenses when they are paid. This provides the flexibility farmers need to plan for major business investments and in many cases provides guaranteed availability of some agricultural inputs.

Under a progressive tax rate system, farmers and ranchers, whose incomes can fluctuate widely from year to year, will pay more total taxes over a period of time than taxpayers with more stable incomes. The flexibility of cash accounting also allows farmers to manage their tax burden on an annual basis by controlling the timing of revenue to balance against expenses and target an optimum level of income for tax purposes.

Loss of cash accounting would create a situation where a farmer or rancher might have to pay taxes on income before receiving payment for sold commodities. Not only would this create cash flow problems, but it also could necessitate a loan to cover ongoing expenses until payment is received. The use of cash accounting helps to mitigate this challenge by allowing farm business owners to make tax payments after they receive payment for their commodities.

DEDUCTING INTEREST EXPENSE IS IMPORTANT FOR FINANCING

Debt service is an ongoing and significant cost of doing business for farmers and ranchers who must rely on borrowed money to buy production inputs, vehicles and equipment, and land and buildings. Interest paid on these loans should be deductible because interest is a legitimate business expense. According to USDA Economic Research Service, the interest expense accounts for 17.9 percent of fixed expenses for farms and ranches. Immediate expensing will not offset the loss of this deduction, especially for the bulk of farmers and ranchers currently covered under Sect. 179 small business expensing.

Farm and ranch businesses are almost completely debt financed with little to no access to investment capital to finance the purchase of land and production supplies. In 2015, all but

5 percent of farm sector debt was held by banks, life insurance companies and government agencies. Without a deduction for interest, it would be harder to borrow money to purchase land and production inputs and the agriculture sector could stagnate.

Land has always been farmers’ greatest asset, with real estate accounting for 79 percent of total farm assets in 2015. Since almost all land purchases require debt financing, the loss of the deduction for mortgage interest would make it more difficult to cash flow loan payments and could even make it impossible for some to secure financing at all. The need for debt financing is especially critical for new and beginning farmers who need to borrow funds to start their businesses.

REPEALING ESTATE TAXES WILL AID IN FARM TRANSISTIONS

Estate taxes disrupt the transition of farm and ranch businesses from one generation to the next. Farm Bureau supports estate tax repeal, opposes the collection of capital gains taxes at death and supports the continuation of unlimited stepped-up basis.

Farming and ranching is both a way of life and a way of making a living for the millions of individuals, family partnerships and family corporations that own more than 99 percent of our nation’s more than 2 million farms and ranches. Many farms and ranches are multi-generation businesses, with some having been in the family since the founding of our nation.

Many farmers and ranchers have benefited greatly from congressional action that increased the estate tax exemption to $5 million indexed for inflation, provided portability between spouses, and continued the stepped-up basis. Instead of spending money on life insurance and estate planning, farmers are able to upgrade buildings and purchase equipment and livestock. And more importantly, they have been able to continue farming when a family member dies without having to sell land, livestock or equipment to pay the tax.

In spite of this much-appreciated relief, estate taxes are still a pressing problem for some agricultural producers. One reason is that the indexed estate tax exemption, now $5.49 million, is still catching up with recent increases in farmland values. While increases in cropland values have moderated over the last three years, cropland values remain high. On average cropland values are 62 percent higher than they were a decade ago. As a result, more farms and ranches now top the estate tax exemption. With 91 percent of farm and ranch assets illiquid, producers have few options when it comes to generating cash to pay the estate tax.

REDUCED TAXATION OF CAPITAL GAINS ENCOURAGES INVESTMENT

The impact of capital gains taxes on farming and ranching is significant. Production agriculture requires large investments in land and buildings that are held for long periods of time during which land values can more than triple. USDA survey data suggestsabout 40 percent of all family farms and ranches report some gain or loss, more than three times the average individual taxpayer. Farm Bureau supports reducing capital gains tax rates and wants an exclusion for farm land that remains in production.

Capital gains taxes are owed when farm or ranch land, buildings, breeding livestock and some timber are sold. While long-term capital gains are taxed at a lower rate than ordinary income to encourage investment and in recognition that long-term investments involve risk, the tax can still discourage property transfers or alternatively lead to a higher asking price.

Land and buildings typically account for 79 percent of farm or ranch assets. The current top capital gains tax is 20 percent. Because the capital gains tax applies to transfers, it provides an incentive to hold rather than sell land. This makes it harder for new farmers and producers who want to expand their business, say to include a child, to acquire property. It also reduces the flexibility farms and ranches need to adjust their business structures to maximize use of their capital.

STEPPED-UP BASIS REDUCES TAXES FOR THE NEXT GENERATION OF PRODUCERS

There is also interplay between estate taxes and capital gains taxes: stepped-up basis. Step-up sets the starting basis (value) of land and buildings at what the property is worth when it is inherited. Farm Bureau supports continuation of stepped-up basis.

Capital gains taxes on inherited assets are owed only when sold and only on gains over the stepped-up value. If capital gains taxes were imposed at death or if stepped-up basis were repealed, a new capital gains tax would be created and the implications of capital gains taxes as described above would be magnified. This is especially true for the vast majority of farmers and ranchers who are both under the estate tax exemption and have the benefit of stepped-up basis.

Stepped-up basis is also important to the financial management of farms and ranches that continue after the death of a family member. Not only are land and buildings eligible for stepped-up basis at death but so is equipment, livestock, stored grains, and stored feed. The new basis assigned to these assets resets depreciation schedules, providing farmers and ranchers with an expanded depreciation deduction.

LIKE-KIND EXCHANGES HELP AG PRODUCERS STAY COMPETITIVE

Like-kind exchanges help farmers and ranchers operate more efficient businesses by allowing them to defer taxes when they sell assets and purchase replacement property of a like-kind. Farm Bureau supports the continuation of Sect. 1031 like-kind exchanges.

Like-kind exchanges have existed since 1921 and are used by farmers and ranchers to exchange land and buildings, equipment, and breeding and production livestock. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to continue their farm or ranch businesses or, worse yet, delay mandatory improvements to maintain the financial viability of their farm or ranch.

FARMERS AND RANCHERS PAY SIGNIFICANT STATE AND LOCAL TAXES

Farm Bureau supports continuation of the deduction for state and local taxes. Loss of the deduction for state and local taxes paid would have a significant impact on farm and ranch businesses. According to USDA Economic Research Service, state and local property taxes account for 16 percent of fixed expenses for all farms. An additional, important contributing factor is that taxes are often built into the price of rent and lease payments, which are substantial for farms. Therefore, losing the state and local tax deduction would likely cause higher rent and lease payments. It should be noted that the figures for taxes mentioned above are only for real estate and property taxes and do not include any state income taxes if those exist. Therefore, the overall local and state tax burden is likely higher then stated above.

SUMMARY

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue-neutral and fair to farmers and ranchers. Tax reform should embrace the following overarching principles:

- Comprehensive: Tax reform should help all farm and ranch businesses, including sole-proprietors, partnerships and sub-S and C corporations.
- Effective Tax Rate: Tax reform should reduce combined income and self-employment tax rates low enough to account for any deductions/credits lost due to base broadening.
- Cost Recovery: Tax reform should allow businesses to deduct expenses when incurred, including business interest expense. Cash accounting should continue. Sect. 1031 like-kind exchanges should continue. There should be a deduction for state and local taxes.
- Estate Taxes: Tax reform should repeal estate taxes. Stepped-up basis should continue.
- Capital Gains Taxes: Tax reform should lower taxes on capital investments. Capital gains taxes should not be levied on transfers at death.