AMERICAN FARM BUREAU FEDERATION®
600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024

ph. 202.406.3600
f. 202.406.3602
www.fb.org

CASH ACCOUNTING

Issue:

Cash accounting combined with the ability to accelerate expenses and defer income gives farmers and ranchers the flexibility they need to optimize cash flow for business success, plan for business purchases and manage their tax burden by targeting an advantageous level of taxable income. Accrual accounting complicates farm and ranch management and takes away the flexibility needed to deal with uncontrollable weather and unpredictable markets. Under current law, only C-corp farms and ranches with over $25 million of gross receipts are required to use accrual accounting.

Background:

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 gives them the flexibility they need to plan for major investments in their businesses and in many cases provides guaranteed availability of some agricultural inputs. Accrual accounting complicates farm management because the growing of crops and raising of livestock is a production activity that can't be expensed and instead would be accumulated as inventory and deducted when the commodity is sold.

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 unless they are allowed to take advantage of tax tools to even out taxable income. Cash accounting gives farmers and ranchers the flexibility 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 could create a situation where a farmer or rancher would have to pay taxes on income before receiving payment for sold commodities. Not only would paying the tax become difficult, but cash flow problems 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.

Many farms and ranches do not employ professional accountants or bookkeepers; instead, family members maintain financial records. The loss of cash accounting would require extra bookkeeping, including but not limited to tracking inventory, accounts receivable and accounts payable. Given that agricultural operations run on thin margins and are "price takers" unable to pass on added costs to their customers, any impact of increased administrative expenses could be significant.

While some industries with a high level of gross receipts are able to absorb the impacts of accrual accounting, this is not true for agricultural businesses. Because farms and ranches typically have high input costs, a high level of gross receipts does not necessarily translate into profitability. Gross receipts thresholds that trigger accrual accounting are problematic because high commodity prices, inflation and other market conditions could cause a farm operation to alternately surpass and then dip below the threshold on a year by year basis.

In addition, IRS aggregation rules could faultily require farm and ranch businesses to switch to accrual accounting because multiple related businesses must combine their income when calculating gross receipts. Agricultural operations are often divided into several related businesses that, when aggregated, have combined gross receipts over the accrual threshold. When this happens, each of the related businesses would be required to use the accrual method of accounting.

Legislative Status:

The House Republican Tax Reform Blueprint does not address the continuation of cash accounting.

AFBF Policy:

Cash accounting is the preferred method of accounting for farmers and ranchers. It gives them the flexibility they need to optimize cash flow for business success, plan for business purchases and manage their tax burden by targeting an advantageous level of taxable income. Any change that forces an agricultural operation to switch from cash to accrual accounting will have negative financial consequences and add complexity to the financial management of farm and ranch businesses.

Contact: Pat Wolff, 202-406-3670, patw@fb.org