Tax Reform
Policy Development May 2011

Issue:

Congressional fact-finding hearings are underway that could lead to an overhaul of the federal tax code. As in 1986, when the tax code was last rewritten, Congress will most likely opt to modify the tax code instead of doing a full rewrite. Farm Bureau is on record in support of repealing the estate tax, the alternative minimum tax (AMT) and capital gains taxes. Individuals, family partnerships and family corporations own 98 percent of our nation's two million farms and ranches. It is important that tax reform policy is handled responsibly as potential policies could not only cripple agricultural operations, but could also hurt the rural communities and businesses that agriculture supports.

Background:

Farm Bureau supports replacing the current federal income tax system and believes that when temporary tax provisions end in 2012, the modified tax code should encourage, not penalize, success, savings, investment and entrepreneurship. Furthermore, the modified tax code needs to be transparent and simple and require collection of a minimum amount of personal information. However, are there tax code provisions so important to farmers and ranchers that they should be off the tax reform table? Are cash accounting, deferring income, prepaid expenses and Section 179 important tax code provisions that farmers and ranchers need in order to operate a profitable business?

Cash accounting is advantageous to farmers and ranchers because it allows for the deferral of income and an acceleration of expenses. The cash accounting method provides the flexibility to farmers and ranchers to manage their tax burden on an annual basis by allowing them to target an optimum level of taxable income. This is important to farmers and ranchers because of the relatively long time period between the purchase of inputs and the sale of their commodity. Cash accounting allows for simplicity of record keeping and a reduction in taxes, especially given that projected 2011 production expenses are forecasted to be seven percent higher than 2010, exceeding $300 billion for the first time.

Deferral of income is an important tax provision to farmers and ranchers because agricultural products are often sold under deferred arrangements. Deferred arrangements allow for the payment for the commodity or product to be made in the year after the sale takes place. One benefit of deferring income is that progressive rates cause more total tax to be paid when high incomes are reported in some years and low incomes in other years.

Prepaid expenses are the amounts paid by farmers and ranchers for fertilizer, seed, feed or other input costs, to the extent that the input item has not been used or consumed during the most current tax year. However, prepaid expenses can only be used under the cash accounting method. Farmers and ranchers have the opportunity to deduct prepaid expenses of up to 50 percent of all other deductible farm costs for that current tax year. Prepaid expenses over 50 percent in the current tax year must be deferred to the next year in which the item is used. Given projected record production expenses for 2011, deducting prepaid expenses will reduce taxes and provide farmers and ranchers flexibility in an industry where "change of plans" occur frequently due to uncontrollable circumstances.

Section 179 is important to farmers and ranchers because agriculture is an equipment-intensive industry in order to operate in the most efficient manner. In 2010, nearly $130 billion was used for agricultural equipment and machinery. The share of farm assets attributable to machinery and farm-use motor vehicles makes up six percent of total assets owned by farmers and ranchers. The Tax Relief Act of 2010 and the Jobs Act of 2010 impacted Section 179 by temporarily increasing the deduction limit to $500,000 for both old and new equipment, and increasing the total amount of equipment that can be purchased up to $2 million.

Questions:

Current policy is written to support replacing the current income tax with a national sales tax. With Congress moving forward with plans to overhaul, not replace, the tax code, should changes be made to Farm Bureau policy?

Are there tax code provisions so important to farmers and ranchers that they should be off the tax reform table? What are they?

How do provisions such as cash accounting, deferring income, prepaid expenses and Section 179 expensing and other depreciation rules compare in importance to other tax code provisions?

Are there tax code provisions that would be worth giving up in exchange for lower rates?

Farm Bureau Policy:

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Lines 1-18 (paraphrased)
We support replacing the current federal income tax system. The new tax code should encourage, not penalize, success and encourage savings, investment and entrepreneurship. It should be transparent, simple and require a minimum of personal information. Any replacement tax system should meet these guidelines:

- Revenue neutral (not increase tax revenue to the federal government)

- Eliminate payroll taxes, the Alternative Minimum Tax, capital gains taxes, and personal and corporate income taxes

- Repeal the 16th amendment (which would prevent the federal government from levying an income tax)

- Based on net, not gross, income

- Not tax business-to-business transactions or services except for final consumption

- Require a two-thirds majority to impose new taxes or increase tax rates