STATEMENT OF THE
AMERICAN FARM BUREAU FEDEATION
TO THE
SENATE FINANCE COMMITTEE
REGARDING
PRESERVING AND PROTECTING MAIN STREET USA

Presented by

Bob Stallman
President

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Chairman Grassley, Ranking Member Baucus and distinguished committee members. My name is Bob Stallman. I am a rice and cattle producer from Columbus, Texas, and I serve as the elected president of the American Farm Bureau Federation. Thank you for this opportunity to talk about tax code changes to help "preserve and protect" farms and ranches.

Farm Bureau commends the committee for holding this hearing to focus attention on farm and ranch needs. While much of America has prospered over the last decade, this was not the case with American agriculture. As all of you know, many farmers and ranchers have suffered substantial financial losses over the last few years. There are many reasons for this and just as many possible solutions. Some of these solutions involve changes in the tax code.

We are pleased that you, Chairman Grassley, and you, Senator Baucus, have recognized many of these tax provisions and introduced them as S. 312. Farm Bureau supports S. 312, the Tax Empowerment and Relief for Farmers and Fishermen Act, and the legislation that carries the bill's components are freestanding measures.

Farm, Fishing and Ranch Risk Management Accounts (FFARRM)

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act – Section 2
S. 313 Farm, Fishing and Ranch Risk Management Act

Unpredictable weather and uncontrollable markets determine whether or not farmers and ranchers will be able to harvest a crop and the price they will receive for the commodities they are able to market. As a result, farmers and ranchers are never certain of their incomes. Serious financial problems arise in low-income years when not enough revenue is generated to cover farm expenses. Farmers and ranchers need new risk management tools that encourage savings as a means of stabilizing their incomes.

Farm Bureau supports the creation of Farm, Fishing and Ranch Risk Management Accounts (FFARRM) to help farmers and ranchers manage risk though savings. Using FFARRM Accounts, agricultural producers would be encouraged to save money in good economic times for the ultimate lean economic years.

Like other small businessmen, farmers and ranchers have predictable expenses. Each month they must pay for fuel, animal feed, equipment repairs, building maintenance, insurance, utilities, and payroll. They must plan for seasonal expenses such as taxes, seed, heat and fertilizer.

And, must also budget for major purchases such as equipment, land and buildings.

While many expenses can be predicted and to some degree controlled, farm income is neither predictable nor controllable. Farmers and ranchers do not know from one year to the next if their gross income will exceed expenses of if their income will fall short of what they need to pay their bills.

FFARRM Accounts would encourage farmers and ranchers to save "for a rainy day" by deferring income tax, but not self-employment taxes, on up to 20 percent of their net farm income. Money could remain in the account for no more than five years and would be subject to income taxes at withdrawal while interest would be taxed as it is earned. Safeguards in the bill limit the use of FFARRM accounts to bonafide farmers and ranchers and require that FFARRM funds be held in interest-bearing accounts.

Self-employment Taxes

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act – Sections 3 and 4
S. 315 Conservation Reserve Program Tax Fairness Act of 2001
S. 369

Most farmers and ranchers are self-employed. As you know, they currently pay self-employment (SE) tax at the rate of 15.3 percent on earned income. The self-employment tax does not ordinarily apply to rental income, because rental income represents a return on investment not on earned income.

In 1996, a tax court case (Mizell case) imposed new SE taxes on cash rental income received by some farmers and ranchers. As a result landlords, who are actively involved in a partnership or corporation that farms their land, must pay SE tax on rental income. The Mizell decision doesn't apply to any other group of taxpayers, which means that farmers are being taxed differently than other rental property owners. While a recent Eleventh Circuit appellate ruling (McNamara, Bot and Hennen) sided with farmers, additional IRS legal action could still occur and the obligation to pay SE taxes on cash rental income remains clouded.

Also in 1996, the tax court ruled (Wuebker Case) that Conservation Reserve Program (CRP) payments were considered rental payments and therefore would not be subject to the self-employment tax. USDA makes CRP payments to owners and operators of land who sign a rental agreement and agree to refrain from farming the enrolled property in order to conserve and improve the environmental resources of that land. CRP covers almost 34 million acres of environmentally-sensitive land.

But in March 2000, the Sixth Circuit Court of Appeals reversed the tax court's opinion, placing an additional tax burden of 15.3 percent on farmers for their CRP payments and allowing the Internal Revenue Service to retroactively collect these taxes from the last four years on farmers participating in CRP.

It is unfair to treat active farmers and ranchers differently from other taxpayers when imposing self-employment taxes on rental income. Because of the Mizell and Wuebker cases, the IRS now singles out farmers and ranchers as landlords liable for the self-employment tax. For other taxpayers who receive CRP payments and cash rental payments, and are not materially participating in a farming operation, the payments are considered to be rental income not subject to self-employment tax.

The CRP issue not only impacts farmers and ranchers, but also the environment. Self-employment tax on CRP payments may discourage farmers and ranchers from future participation in this program. Environmentally-sensitive acreage that has been taken out of production to protect its natural resources may be forced back into production if CRP payments are subject to self-employment taxes.

Farm Bureau believes that farmers and ranchers should be treated the same as other taxpayers and not have to pay self-employment taxes on unearned income like CRP payments and the cash rental of land.

Income Averaging and the Alternative Minimum Tax

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act – Section 8

Farm income averaging provides farmers and ranchers with a valuable tax management tool. The intended benefits of income averaging, however, are being eroded by the Alternative Minimum Tax (AMT) for some farmers and ranchers who use income averaging. Producers who stand to benefit the most from income averaging, those whose incomes vary greatly from year to year, are hurt most by AMT-imposed limits on farm and ranch income averaging.

Income averaging helps assure the long-term viability of production agriculture because farmers and ranchers are no longer overtaxed in profitable years leaving more funds to pay expenses and prepare for the next economic downturn. Without income averaging, farmers and ranchers pay more in taxes than people with steady incomes even though they both had the same aggregate earnings over time. By implementing income averaging, Congress ensured that effective tax rates would be the same for agriculture producers and other taxpayers.

Farm Bureau supports legislation to ensure that farmers and ranchers are able to take full benefit of income averaging without the added burden of paying the Alternative Minimum Tax.

Charitable Deduction for Contributions of Food Inventory

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act – Section 7
S. 37 Good Samaritan Hunger Relief Tax Incentive Act

Despite the wealth of our country, low food prices and ongoing government food assistance programs, some people still have difficulty purchasing food for a proper diet. Farm Bureau believes that tax policy should encourage individuals and companies to do all they can to help people in need. Farm Bureau supports legislation designed to increase donations to food banks, soup kitchens and other hunger relief charities by creating a charitable deduction for contributions of food inventories.

Small Ethanol Producer Credit

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act – Section 11

Farm Bureau has been an aggressive supporter of expanding the production and use of ethanol. The energy supply problems of the last few years have made ethanol an even more important part of the total energy supply for the country. The small ethanol producer credit program provides incentives for producers of alternative energy to boost production. The U.S. Department of Agriculture program will reimburse plants that increase production for the commodities used to make ethanol.

Changing the definition of a small ethanol producer would be a tremendous boost for small ethanol plant producers. It would give them an economic incentive to enhance the output of each plant that participates in the program. Currently the program covers 42 ethanol and 12 bio-diesel makers in 19 states. It is projected that these plants will increase ethanol production by 264 million gallons and boost bio-diesel production by 37 million gallons. Expanding the parameters to the next tier of plants, to producers of 60 million gallons, would almost double these numbers.

Other Tax Issues Important to Farmers and Ranchers

S. 362

Farming and ranching is a capital-intensive industry that requires huge investments in buildings, equipment and land to produce food and fiber. When they sell a farm asset, agriculture producers pay capital gains taxes on the amount that asset has increased in value while they owned it. This tax can be huge because on the average, farmers and ranchers own their land for 30 years during which it increases in value five to six times.

To remain efficient and profitable, farmers and ranchers must constantly adapt their businesses to produce the goods wanted by American and overseas consumers. Because capital gains taxes are imposed when buildings, breeding livestock and farmland is sold, producers are discouraged from selling unneeded assets to adapt and upgrade their operations.

Capital gains taxes also threaten the transfer of farmland between agricultural producers. Capital gains taxes increase the price of land making it more difficult for children to take over farms while their parents are still alive. The tax makes it harder for farmers to acquire land to expand so that additional family members can enter the business. In addition, capital gains taxes make it more difficult for family members who want to keep farming to buy out their non-farming relatives who may have inherited part of the farm.

Congress increased the homeowner exclusion in 1997 and made the benefit usable once every two years. While these improvements were very helpful for homeowners, the benefits for farmers and ranchers are limited. Unlike homeowners who tend to buy and sell homes multiple times during their lives, farmers tend to live in their homes until they leave their farms. And, unlike many taxpayers whose homes represent their most valuable asset, a house on a working farm has a low value because it can’t be easily separated from the farm operation.

Farm Bureau supports, S. 362, legislation to expand the $500,000 per couple homeowner capital gains exclusion to include farmland. A broadening of this exemption will insert a measure of equity into the tax code. We also believe that the maximum capital gains tax rates should be reduced to no more than 15 percent. Enactment of these provisions will allow assets to move to their best and most productive use.

S. 275 Estate Tax Elimination Act of 2001

No Farm Bureau statement on taxes would be complete without a statement on death taxes. Eliminating death taxes is the top tax priority of our organization. Families own 99 percent of our nation’s farms and ranches and unless death taxes are repealed, many of these family farms are at risk. The impact of death taxes, with rates as high as 55 percent, is so severe that its imposition can destroy farm businesses. When this happens open space can be lost, surviving family members can be displaced, employees can lose their jobs and rural communities can lose their economic base. Farm Bureau has endorsed S. 275 because it eliminates death taxes immediately while preserving the stepped-up basis for assets worth $2.8 million/per person, $5.6 million/per couple.

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