U.S. SENATE COMMITTEE ON
Finance
SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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Grassley Re-introduces Bill to Help Save Family Farms

WASHINGTON — Sen. Chuck Grassley, chairman of the tax-writing Committee on Finance, last night re-introduced a package of tax relief measures to help preserve family farms and fisheries.

"This bill will help family farmers across the country," Grassley said. "With the number of family farms shrinking every year, it seems all of us ought to be doing everything we can to help independent producers survive. Our safe and abundant food supply depends on it. That's true not only for the United States, but also for the countries around the world that receive our food products."

The legislation, the *Tax Empowerment and Relief for Farmers and Fishermen Act (TERFF)* (S. 665), has 12 bipartisan, original co-sponsors. The bill is very similar to Grassley's TERFF Act in the last Congress, which was scheduled for committee consideration but along with other pending bills, didn't receive final approval before adjournment. The bill includes the following:

- **FFARRM Accounts**. These farmer savings accounts would allow farmers to contribute up to 20 percent of their income in an account, and deduct it in the same year. FFARRM accounts would be a very important risk management tool to help farmers put away money when there's actual income, so that in the really bad times there would be a safety net. This Grassley-sponsored measure enjoys strong bipartisan support and was approved in 1999 as part of the *Taxpayer Relief Act,* which President Clinton vetoed.

- **Reversing unfair IRS decisions on self-employment tax for farmers**. Grassley said farmers who participate in the Conservation Reserve Program are unnecessarily struggling during tax season because of a case pursued by the IRS. Court rulings treat CRP as farm income subject to the additional self-employment tax rate of 15 percent. Sen. Sam Brownback of Kansas has taken the lead on fixing this problem. This unfair tax not only ignores the intent of Congress in creating the CRP, but it also discourages farmers from using environmentally pro-active measures. "At a time when farmers are struggling to regain their footing economically and do the right thing environmentally, it's important that Congress support them by upholding its promise on CRP," Grassley said.

  In addition, the bill includes a Grassley provision to reverse an IRS attempt to apply the self-employment tax on farmers' cash rental income.

- **A tax deduction for farmers and restaurants to donate to food banks**. Sen. Richard Lugar of Indiana has led an effort to expand the current program in which companies can donate to food banks so that farmers can donate surplus food directly to needy food banks. Grassley said it would be "a win for the farmers and a big win for people who depend on food bank assistance."

Specifically, Lugar's *Hunger Relief Tax Incentive Act* would make changes to the federal tax code that could greatly enhance the ability of local food pantries, homeless shelters and non-profit organizations to stock their shelves and help feed hungry families. It would let farmers, restaurant owners and small businesses take advantage of the tax deduction for food donations now available only to corporations. It would increase the tax deduction for donated food to include expenses incurred by the business owner or farmer.

"Every year, 96 billion pounds of food goes to waste. We need to encourage new and existing food donors to contribute to the campaign against hunger," Grassley said.

- **Income averaging for farmers who are caught in the Alternative Minimum Tax**. When Congress passed income averaging for farmers a few years ago, it neglected to take into account the problem of running into the alternative minimum tax, which many farmers are facing now. Grassley said this legislation would fix this growing problem.

- **Expansion of first-time farmer loans, or Aggie Bonds**. This expands opportunities for beginning farmers who are in need of low-interest rate loans for capital purchases of farmland and equipment. Current law permits state authorities to issue tax-exempt bonds and to lend the proceeds from the sale of the bonds to beginning farmers and ranchers to finance the cost of acquiring land, buildings and equipment used in a farm or ranch operation.

  Unfortunately, Aggie Bonds are subjected to a volume cap and must compete with big industrial projects for bond allocation. Grassley said Aggie Bonds share few similarities to Industrial Revenue Bonds and should not be subjected to the volume cap established for IRBs. Insufficient allocation of funding due to the volume cap limits the effectiveness of this program. "We can't stand by and allow the next generation of farmers to lose an opportunity to participate in farming because of competition with industry for reduced interest loan rates," Grassley said.

- **Farmer co-op initiatives**. Recently the IRS determined that some cooperatives should be exposed to a regular corporate tax due to the fact that they are using organic value-added practices rather than manufactured value-added practices. "This is unfair, and needs to be fixed," Grassley said. In addition, he said, small cooperative producers of ethanol should be allowed to be able to receive the same tax benefits as large companies. Grassley's legislation addresses these problems. Overall, Grassley said, this bill "would do more for the American farmer regarding taxes than any measure in recent memory."

  A detailed summary follows.

Summary of the *Tax Empowerment and Relief for Farmers and Fisherman (TERFF) Act* (S. 665)
(S. 312 during the 107th Congress)

The bill includes a number of tax provisions that will be generally beneficial to farmers and four tax provisions aimed at helping farmer cooperatives.

<u>The tax provisions that will generally assist farmers are as follows</u>:

1. The creation of Farm, Fish and Ranch and Risk Management Accounts (FFARM Accounts);
2. a provision to exclude rental income from self-employment tax;
3. a provision to exclude Conservation Reserve Program payments from self-employment tax;
4. a provision to exempt agricultural bonds from the private activity bond volume cap;
5. a provision to enhance the charitable deduction for contributions of food inventory;
6. a provision that will allow farmers and fisherman using income averaging to not be subject to the alternative minimum tax; and
7. an extension of the replacement period for livestock lost or sold due to drought.

<u>The cooperative provisions are as follows</u>:

8. A provision to modify the dividend allocation rule, that if modified will help cooperatives raise equity by allowing for the payment of dividends on preferred stock without penalty, while at the same time increasing the amount of patronage dividends paid to farmer members;
9. a provision to expand the definition of cooperative marketing to include value-added processing through animals;
10. a provision to extend the declaratory judgment procedures of IRC 1724 to 521 farmer cooperatives; and
11. a provision that will allow the 10-cent credit for small cooperative processors of renewable fuels to be passed to the farmer owners.

12. Modifications to section 512(b)(13).

<u>Following is an expanded summary of the new tax provisions that will be directly beneficial to farmers</u>:

1. Farm, Fish and Ranch and Risk Management Accounts (FFARM Accounts) – The bill creates a new elective deferral of farm and fishing income by allowing taxpayers engaged in an eligible business to establish FFARM accounts. Contributions to FFARM accounts are deductible and limited to 20 percent of the taxable income that is attributable to the eligible business. The amount can remain on deposit in a FFARM account for up to five-years. A FFARM account is taxed as a grantor trust and any earnings are required to be distributed currently and taxed upon distribution.

2. Exclusion of Rental Income From Self-Employment Tax -- Generally, SECA taxes are imposed on an individual's net earnings from self-employment. One exclusion from net earnings from self-employment involves certain real estate rentals. Under this rule, net earnings from self employment do not include income from the rental of real estate and from personal property leased with the real estate unless the rental income is received under an arrangement between an owner or tenant of land and another individual that provides: 1) the other individual produce agricultural or horticultural commodities ...; and 2) there shall be material participation by the owner or tenant with respect to the commodities.

The bill provides that net earnings from self employment do not include income from the rental or real estate under a lease agreement (rather than an arrangement) between an owner or tenant of land and another individual which provides that: 1) the individual produce commodities on the land; and 2) there shall be material participation by the owner or tenant in the production or management of the production of the commodities.

3. Exclusion of Conservation Reserve Program Payments from Self Employment Tax -- Generally SECA is imposed on an individual's net earning from self-employment. A court decision found that payments made under the Conservation Reserve Program can be included in an individual's self-employment income for purposes of SECA tax.

The bill provides that net earnings from self-employment do not include Conservation Reserve Program payments for SECA.

4. Exemption of Agricultural Bonds From Private Activity Bond Volume Cap – "Aggie Bonds" are tax-exempt private activity bonds, which are issued to finance loans to first-time farmers for the acquisition of land and certain equipment. The volume of tax-exempt private activity bonds that states and local governments may issue in each calendar year is limited by state-wide volume limits.

The bill exempts "aggie bonds" from the state volume limits.

5. Charitable Deduction for Contributions of Food Inventory -- The Code gives special tax treatment to food inventory donations made by C corporations. S corporations, personal holding companies, and service organizations are not eligible donors.

The bill amends section 170 of the code to expand the augmented deduction for the donation of food inventory under section 170(e)(3) to any taxpayer engaged in the trade or business of farming.

6. Coordinate Farmers and Fisherman Income Averaging and the Alternative Minimum Tax -- Currently, a farmer may compute his or her tax liability by averaging the income during the previous three-year period. However, the averaging election is not coordinated with the alternative minimum tax and some farmers may be subject to the alternative minimum tax as a result of the averaging.

The bill extends to those engaged in the business of fishing the income averaging election that is currently available to farmers, and coordinates both the farmers and fisherman income averaging with the alternative minimum tax.

7. Extension of Replacement Period for Livestock Lost or Sold due to Drought -- Current law requires livestock lost or sold due to drought to be replaced within 2 years. This legislation would extend this deadline to 4 years. This provision is critical for farmers who have already experienced two years of drought but who cannot replace their livestock because they continue to suffer from severe drought.

<u>The new tax provisions that will be beneficial to farmer cooperatives and farmers</u>:

8. Cooperative Marketing to Include Value Added Processing Through Animals – Tax-exempt cooperatives (section 521) are cooperatives of farmers, fruit growers and like organizations organized and operated on a cooperative basis for the purpose of marketing the products of members or other producers and then returning the net margins to members.

The IRS has taken the position that a cooperative is not marketing the products of members or other producers where the cooperative adds value through the use of animals (e.g., farmers send corn to a cooperative, which is fed to chickens which produce the eggs and the cooperative markets the eggs).

The bill provides that marketing products of members or other producers includes feeding products of members or other producers to cattle, hogs, fish, chickens or other animals and selling the resulting animals or animal products.

9. Extends Declaratory Judgment Procedures to section 521 Farmer Cooperatives -- Under current law there is limited access to judicial review of disputes regarding the initial or continuing qualification of section 521 farmer cooperatives. The current remedies include filing a petition in U.S. Tax Court for relief following a notice of deficiency or to pay a tax and sue for a refund in a U.S. district court of the U.S. Court of Federal Claims.

The bill extends the limited declaratory judgment procedures, which generally permit a taxpayer to seek judicial review of an IRS determination prior to the issuance of a notice of deficiency and prior to payment of tax, to section 521 cooperatives. For example, currently where the IRS denies an organization's application for recognition of exemption under section 501(c)(3) or fails to act on an application, or revokes or adversely modifies its tax-exempt status, current law allows this organization to seek a declaratory judgment regarding its tax-exempt status. The bill extends similar treatment to section 521 cooperatives.

10. Small Ethanol Producer Credit -- Small ethanol producers are allowed a 10-cent per gallon production income tax credit on up to 15 million gallons of production annually. This credit is in addition to the 54-cents-per-gallon benefit available for ethanol generally.

The 10-cent-per gallon tax credit is not currently passed through to patrons of a cooperative and the bill allows a cooperative to elect to allocate the small ethanol producer credits to its patrons.

The bill also provides that the small producer tax credit is not a "passive credit"; allows the credit to be claimed against the alternative minimum tax; and repeals the rule that amount of the credit is included in income.

11. Payment of Dividends on Stock of Cooperatives Without Reducing Patronage Dividends -- Current Treasury regulations provide that net earnings are reduced by dividends paid on capital stock or other proprietary interests. The effect of this rule is to reduce the amount of earnings that the cooperative can treat as patronage earnings which reduces the amount that a cooperative can deduct as patronage dividends.

The bill allows cooperatives to pay dividends on capital stock without those dividends reducing excludable patronage-sourced income to the extent the cooperatives organizational documents provide that the dividends do not reduce amounts owed to patrons.

12. Modifications to Section 512(b)(13) -- The bill addresses the unrelated business income of tax-exempt organization under section 512(b)(13) of the Code.