S. HRG. 102-831

FARM TAX FAIRNESS

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

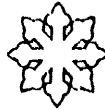
ONE HUNDRED SECOND CONGRESS

SECOND SESSION

ON

S. 710, S. 887, S. 900, S. 1045, S. 1061, S. 1130, S. 2202, and H.R. 1711

APRIL 29, 1992



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FARM TAX FAIRNESS

WEDNESDAY, APRIL 29, 1992

U.S. SENATE,
SUBCOMMITTEE ON ENERGY AND
AGRICULTURAL TAXATION,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 2:05 p.m., in room SD–215, Dirksen Senate Office Building, Hon. Tom Daschle (chairman of the subcommittee) presiding.

Also present: Senator Grassley.

[The press release announcing the hearing follows:]

[Press Release H–20, April 23, 1992]

DASCHLE SCHEDULES HEARING ON FARM TAX FAIRNESS, SUBCOMMITTEE TO EXAMINE POSSIBLE CHANGES IN TAX CODE

WASHINGTON, DC.—Senator Tom Daschle, Chairman of the Senate Finance Subcommittee on Energy and Agricultural Taxation, Thursday announced a hearing on farm tax fairness.

The hearing will be at *2 p.m., Wednesday, April 29, 1992* in Room SD–215 of the Dirksen Senate Office Building.

Daschle (D., South Dakota) said the hearing will focus on tax incentives for first-time farmers, estate and gift tax issues of transferring a farm to children, and capital gains and debt relief.

"This hearing will give us the opportunity to examine changes needed in the Tax Code to make it fairer for family farmers," Daschle said.

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA, CHAIRMAN OF THE SUBCOMMITTEE

Senator DASCHLE. The hearing will come to order. I want to welcome everybody here this afternoon. We are here to discuss certain aspects of the Tax Code as it applies to agriculture.

In the context of this issue, we are going to cover a number of proposals pending before the Finance Committee that seek to provide tax relief to farmers in a number of specifically identified areas.

Unfortunately, efforts to enact broad tax fairness and economic growth legislation have failed this year. Nonetheless, I believe it is an appropriate time to learn more about the economic health of agriculture and to better understand how the Tax Code helps or hinders the survival of our Nation's family farms.

I am told that seven percent of farmers are currently facing severe financial vulnerability, meaning that they have a debt-to-asset ratio of 40 percent or higher, and a negative cash flow.

Although this is down from the 12 percent level of the mid-1980s during the Great Farm Crisis, continued low commodity prices, coupled with the damaging natural disasters we have seen, threaten to push that percentage higher today.

Today's hearing will focus primarily on the impact of the Tax Code on farmers in three areas. First-time farmer assistance. As corporate farming continues to grow, family farms are dwindling and fewer young people are entering the business of farming.

When I conduct public meetings with farmers in my State, I rarely see young faces in the crowd. Nationally, 50 percent of farm assets are controlled by persons likely to retire within the next 10 years.

If we are going to maintain a strong agricultural economy in the 21st century, we have to do a better job of attracting our young people to farming. The Tax Code is one tool with which to do that.

The second area we will consider involves transferring the farm to children, estate and gift tax issues. Under current law, for estate tax purposes, farm property may be valued in its special use as a farm, so long as inheriting family members continue to use it as a farm.

Current interpretations of this Tax Code provision have threatened the availability of special use valuation for those who inherit farm property and could lead to substantial tax assessments for many unwary farmers.

The third area is capital gains and debt relief. Today, farmers who run into financial difficulties and are forced to work out their debt with creditors often find that these transactions result in taxable capital gains and cancellation-of-indebtedness income.

Other farmers are hit hard by capital gains taxes when they sell their farms, hoping to live off the proceeds for retirement. For too many, the current Tax Code leaves them little, if anything, for retirement after a long and productive lifetime of family farming.

That does not seem fair. We should investigate the possibility of providing improved vehicles for converting equity in one's farm into a retirement fund of some kind.

Family farmers have served our country well from the days of the first settlers. They have helped to make our country the envy of the world by continuously producing quality commodities in quantities sufficient to feed America and many of the world's hungry. Family farms are a precious natural resource that we must preserve for future generations.

Today, we will focus on the feasibility of the various tax proposals presented from an agricultural and tax policy perspective. Legitimate questions to ask are, "Will the proposals work?" and "Is it good tax policy?"

In response to a number of queries we have had with regard to the scope of this hearing, let me emphasize at the very beginning that this is the first in a series of hearings that we would like to conduct on the Tax Code as it relates to agriculture.

There are so many provisions we want to assess and consider in greater detail that we simply did not have time to cover all of them today. In the interest of providing as much understanding as possible of these provisions, we chose to lump them in the categories we have today with the expectation that, at some point in the near

future, we will continue this series and hold additional hearings, as time allows and the committee provides.

As always, let me remind each witness that their entire statement will be made part of the record, and we would ask them to summarize their remarks as they come before the committee today.

Before we call on our first witness, let me ask my colleague, Senator Grassley, for his opening comments.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. First of all, thank you for conducting such a hearing on the important issue of agricultural tax incentives. I especially want to thank you for including my proposal, S. 710, which permanently extends the first-time farmer program in this hearing schedule.

I have introduced this legislation in each of the last two Congresses. These first-time farmer bonds, or I call them Aggie Bonds, are part of a larger package of tax-exempt Small Issue Private Activity Bonds that will expire at the end of June this year.

However, on its own, the Aggie Bond program only costs a little under $30 million over a five-year period of time. And, so, with this figure in mind, I do not think we can afford to let such an inexpensive, cost-effective program fall through the cracks of the current budget crisis.

Aggie Bonds are used to finance low-interest farm loans targeted to beginning farmers. The borrower must secure a participating private lender who assumes all of the loan risk.

Federal law limits use of the bonds for loans for first-time farm purchasers, and restricts them to a maximum of $250,000 per family, per lifetime. Of course, State law may impose additional restrictions, such as net worth or residency requirements.

Unfortunately, State programs could be extinguished if the tax-exempt status is lost, since the tax-exempt status is precisely what enables the finance program to issue low-interest loans to first-time farmers.

In addition, continuation of this program could be a real boon for rural development. The program addresses the one problem admitted by the Task Force on Agricultural Finance—that of accessible and affordable credit to beginning farmers.

To date, over 4,200 loans worth more than $250 million have been processed through the Aggie Bond program. The failure rate has been extremely low, 7 percent.

Iowa was the first in the nation to implement an Aggie Bond program, and it has been extremely successful in processing over 1,200 first-time farmer loans since 1981.

I appreciate very much, Mr. Chairman, that you have invited a constituent of mine, Bill Greiner, who heads the Iowa Agriculture Development Authority, to testify before this committee today.

He is truly an expert on the Aggie Bond program, and will be effective in underscoring the need to preserve this program. I thank him very much for taking time out of his busy schedule to be with us to present his testimony, and, more importantly, for his involvement in this program over the years which has been very much the success of the program in my State.

So, thank you, Mr. Chairman. I look forward to considering all of the issues before us today.

Senator DASCHLE. Thank you very much, Senator Grassley.

Our first witness this afternoon is someone who is, perhaps, the most credible expert on agricultural tax issues in the Senate, a former tax commissioner in one of the most agricultural States in the country, and someone who has devoted the last 6 years to agricultural issues and tax matters of consequence to rural America. We are very pleased he could join us, and, Kent, we invite you to proceed as you see fit.

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. Thank you very much, Mr. Chairman. First, I want to thank you for holding this hearing and taking your time to delve into the issues that are facing the committee.

I would ask that my full statement be made part of the record.

Senator DASCHLE. Without objection.

[The prepared statement of Senator Conrad appears in the appendix.]

Senator CONRAD. And I will try to summarize in a way that gets us through this as quickly as possible.

I want to indicate to you, Mr. Chairman, that there will be two witnesses following me; our agricultural commissioner from the State of North Dakota, Sarah Vogel, who has done an absolutely outstanding job in that position for the State of North Dakota, and, more broadly, for the farmers of this country; and David Saxowksy an NDSU economics professor who is very knowledgeable on the subjects that are before the committee. I hope every courtesy of the committee will be extended to them, as I know this Chairman always deals courteously with witnesses.

Mr. Chairman, as you know so well, family farmers suffered severe economic hardship in the 1980s. Net farm income, when adjusted for inflation, was lower in the decade of the 1980s than in any decade since record-keeping began in 1910.

In addition, the net value of farm assets in real dollars dropped from $1.1 trillion to $600 million between 1981 and 1987. With that sharp drop in income and asset values, we saw severe problems develop some of which involved taxes.

Farmers engaged in debt restructuring can, unfortunately, receive large tax bills on either capital gains or ordinary income arising from the transfer of property to satisfy indebtedness or from discharge of indebtedness.

One of the first issues we deal with is what we call phantom capital gains. When a farmer deeds back land to a lender, the IRS treats as a capital gain the difference between the fair market value and the basis in that property, even though the farmer receives no cash from the transfer.

Imagine, Mr. Chairman, the shock of farmers who deed back land to discharge indebtedness and find out, low and behold, that they have a substantial income tax obligation.

They are being forced out of business, in many cases, have virtually no assets, and are faced with very large income tax burdens.

Now, that is the final shock that puts many farmers in a position that is really untenable.

In addition to that problem of phantom capital gains, we have the problem of discharge of indebtedness. Mr. Chairman, as you know, farmers can also find themselves owing tax on debt relief received from a lender, which is considered discharge of indebtedness income by the IRS unless a farmer is insolvent or has unused tax attributes to apply as offsets.

Again, I have seen it. I have had farmers come to me who were ready to finally resolve their economic trauma. They were receiving discharge of indebtedness from a creditor. As a result, they were going to then face huge tax bills, tax bills that they had no resources to pay.

Mr. Chairman, this should not happen, and there is a solution. Now, some have suggested that the Agricultural Credit Act of 1987 was designed to provide farmers with the opportunity to restructure their debt, and that is the case. But many farmers find that they are unable to restructure because of the tax burdens that follow from the situations that I have described above.

Let me just give a quick example. Suppose a farmer had a loan of $200,000 and conveyed back land worth $150,000 to eliminate this debt. Assume this land had a cost basis of $75,000. Under current law, this farmer would have to pay tax on a capital gain of $75,000. That gain is illusory; it will be taxed as ordinary income.

The farmer in this example would also realize $50,000 of discharge of indebtedness income unless he or she is insolvent or has unused tax attributes to apply as offsets.

Mr. Chairman, S. 900 that is before this committee has been cosponsored by the Chairman, and Senator Symms, of Idaho. It has also been supported by Senator Boren, as past Chairman of the subcommittee.

S. 900 it provides a limited, once-in-a-lifetime exclusion for farmers with low to moderate incomes and no other assets to relieve them of the tax owed on discharge of indebtedness income or capital gains that arise from debt restructuring.

Mr. Chairman, let me just review with you very quickly the qualifying test to get this one-time exclusion. First, at least 50 percent of gross receipts in six of the last ten years must be attributable to farming.

Second, modified adjusted gross income is less than 100 percent of the national median adjusted gross income. Finally, equity in all other property is less than $25,000, or 150 percent of the tax liability, whichever is greater.

The exclusion is limited to $300,000; the same limit on the size of the write-down that exists under the Agricultural Credit Act.

Mr. Chairman, Joint Tax has not released a revenue estimate, but it is worth noting that, in real terms, the amount of tax revenue foregone would be minimal, because it is highly unlikely that any of these farmers will ever be able to pay these enormous tax bills when they are flat broke.

Mr. Chairman, another bill I have sponsored S. 1061, a technical correction concerning the special use valuation, is also before the committee. After the large increases in farm prices in the 1970s, many farm families had problems paying their estate taxes.

The law was changed to base estate taxes for family farms on what the farm can actually produce, not on the market value. If the farm is sold outside the family or converted to non-farm use, the heirs are liable for retroactive tax liability.

Therefore, this is not a case where we are opening up a loophole for people to go out, sell land for substantially more than the tax bases on the land, and then reap a tremendous reward.

Following an IRS ruling that leasing farm land on a cash-lease basis disqualified family farms from special use valuation, Congress passed a technical correction in 1988 extending special use valuation of farm property to surviving spouses who continued to cash-rent farm property to their children. Without this change, a recapture tax would have been imposed in such situations.

However, we have found in real life rare instances where there is no surviving spouse and it is not possible, under the 1988 law, to transmit such property to one's children or grandchildren without triggering the recapture tax. S. 1061 would apply in such cases.

For example, we have a case of a North Dakotan, who may have lived very close to South Dakota, now that I think about it, who cash-rented farm property from his mother, who had received the property from her father.

Neither the daughter nor the grandson qualifies for special use valuation under a provision applying only to surviving spouses.

In the House, Congressman Dorgan, of my State, who is a member of the Ways and Means Committee, has introduced companion legislation. In addition, this bill is quite similar to legislation introduced by Senator Kassebaum.

My bill would apply to qualified heirs who are immediate members of the decedent's family, while Senator Kassebaum's bill applies to lineal descendants only. That is the basic distinction between Senator Kassebaum's legislation and my legislation.

Joint Tax has not produce a revenue estimate for this year, but last year indicated that there would be a loss of only $9 million over 5 years, due to the very few number of people affected by this legislation.

It is not very much, but it addresses a serious concern. I hope this committee will look favorably on S. 1061, a technical correction regarding the special use valuation, and on S. 900, the Farm Debt Tax Relief Act. I would be happy to answer any questions.

Senator DASCHLE. Kent, thank you for your testimony. Let me again acknowledge your leadership in both of these areas. I do not know of anyone who can speak with greater credibility about the need for changes in the Tax Code, and you certainly addressed two very important areas.

Let me ask you if you know the percentage of farm liquidations where liabilities currently exceed assets, either in North Dakota, or throughout the Midwest. Any rough figure on that?

Senator CONRAD. I do not. I would be happy to try to get a number for you. I can tell you that we know this is not something that would cost the Federal Government a substantial amount of money.

If you think about it, people affected by the Farm Debt Tax Relief Act are without additional assets, without substantial income, and yet, who, in many cases, face staggering tax bills. I have lit-

erally seen cases where people owe $30,000, $40,000, $50,000 in Federal taxes, and they do not have a dime.

They have gone through the whole process of debt restructuring, and perhaps they are ready to get discharge of indebtedness because creditors have worked with them. Yet, they are faced with huge tax bills, and, at that point, they finally throw up their hands, give up, and go into bankruptcy, in which case there is no chance of work out or relief.

Senator DASCHLE. I think you are absolutely right. I would have to verify this, but something in the back of my mind says it is 25 percent.

Perhaps Sarah can shed some light on this. But 25 percent of farmers today who liquidate find that their debt has exceeded all assets and find themselves in the very position that you have just described. Thank you.

Senator CONRAD. Yes. I would not be surprised if it is that high.

Senator DASCHLE. Thank you very much. We appreciate your testimony.

Senator CONRAD. Thank you.

Senator DASCHLE. Our next witness is also someone who comes from farm country; the senior Senator from the State of Wisconsin. We are pleased he could be with us. Bob, we invite you to present your testimony at this time. Senator Robert Kasten.

STATEMENT OF HON. ROBERT W. KASTEN, A U.S. SENATOR FROM WISCONSIN

Senator KASTEN. Mr. Chairman, first of all, thank you very much. A number of us want to thank you for having this hearing, because there are a lot of different approaches to some of the same problems.

And I think it is important to group these ideas together and I thank you for this opportunity and for the work that your subcommittee is doing on the important topic of retirement security for America's farmers.

I am pleased to note that later in this hearing you are going to be hearing from a Wisconsin farmer, Jim Harris, who is right behind me, he is the architect of the proposal that I am going to be discussing with you, the Farmer's Retirement Account.

And I think it is important that we hear, first of all, from people who are involved day-to-day in agriculture. Jim is a real farmer. He is involved every single day in his farm in Racine County. He came here at his own expense, representing himself, because he feels very, very strongly about these issues.

As you are aware, I believe, Mr. Chairman, we have got, throughout the upper Midwest, some difficult problems with regard to farm income.

Dairy prices, for example, the M–W price just dropped 23 cents from last month. We are now at $10.98, just under $11. A year and a half or so ago, we were above $13.

So, the price for milk in the Dakotas, and Minnesota, and Wisconsin, and Iowa has gone down significantly. And it is with that backdrop that we are trying to struggle for solutions to some of the problems that America's family farmers are faced with.

They need our help, and I think it is particularly important for us to listen to people who have had the day-to-day, on-the-job, full-time experience like Jim Harris. So, I thank you for allowing him to appear.

I also note that Senators Shelby, Burns, Kohl, Cochran and Coats have joined me as co-sponsors of the Farmer's Retirement Account.

In recent months I have held Small Business Committee field hearings throughout Wisconsin. In Racine, in Eau Claire, in Superior, in Green Bay, in West Bend, and in Waukesha. At each of these hearings from small businesses, community organizations and farmers, people have voiced their concern about the overall direction of Wisconsin and America's future.

But they spoke, primarily, of excessive taxation, of massive Federal deficits, the burdens of government red tape, the high cost of health insurance, and the frustration in dealing with a Federal Government that has lost tough with hard-working Americans.

And one of the principal topics discussed was the tremendous struggles that are faced by small- and medium-sized family farms. Today, a dairy farmer in Wisconsin who works a lifetime on the farm and then sells part or all of that farm in the hope of a comfortable retirement faces an immediate 28 percent Federal capital gains tax, and that is, of course, on top of State taxes.

There is no consideration given to the fact that much of the farmer's so- called profit is due solely to inflation—Ken spoke about that a moment ago, and I think a number of us are going to be talking about that all day—or that nobody gives consideration to the fact that farmers do not have access, generally speaking, to company pension and retirement plans, or government pension and retirement plans.

Even their Social Security benefits are often lower than other workers because they pay themselves low wages in order to plow much of their gains back into the farm each year.

Farmers work hard their entire lives. They feed America's families and a good portion of the world. And the gift they get at retirement is a confiscatory tax of one-third the value of their farms.

As two Wisconsin farmers from Union Grove wrote, Chester and Delores Davis:

> While farming and raising a family we had to reinvest any income in machinery or upkeep and could not buy tax-deferred IRAs.
>
> Now they are taking so much of our retirement investment for taxes that it leaves little to retire on. Is this fair?

Senator KASTEN. I think the answer is, it is not fair, and that is why you are having these hearings here today.

Dan Poulson, who is the President of the Wisconsin Farm Bureau observes:

> As farmers, we build a great deal of personal property and other investment into our operations, the investments accrue over a long period of time.
>
> We face exceptional investment risks and the uncertainty of weather problems. Yet, when it comes time to retire, we are faced with a lump-sum tax on the product of our lifelong work and risk-taking.

Senator KASTEN. I believe that farmers deserve better, Mr. Chairman, and the Farmer's Retirement Account is a straight-

forward and simple approach to help farmers build a better retirement for their families.

The proposal does not create a new program, it simply builds on the existing Individual Retirement Account or IRA that is already in place.

Our legislation provides that farmers who sell farm assets be permitted to defer taxation on those assets, provided the profits are rolled over into an Individual Retirement Account.

A similar provision is currently provided for millions of Americans who sell their personal residences each year. Capital gains taxes are deferred, providing the sales proceeds are rolled over into a new residence within 2 years.

So, this mechanism is in place in a couple of different ways, we just need to extend it to include family farms. The Farmer's Retirement Account merely defers taxation and permits the farmer and spouse to spread the eventual payment of taxes out over a number of years as funds are gradually withdrawn from the IRA to meet retirement expenses.

As the Joint Committee on Taxation notes in its analysis of the bills being reviewed at today's hearing: "The rollover of gain on qualified farm property would effectively create income averaging for the taxpayer."

In addition to the benefits to the farmers, the economy is helped, I believe, by the billions of dollars in additional savings invested in IRAs.

The government will not lose a substantial amount of revenue from the Farmer Retirement Account. The Joint Committee on Taxation has provided a 5-year revenue estimate for this proposal. It is $837 million, or less than $200 million per year.

The Farmer's Retirement Account is supported by the American Farm Bureau Federation, the Wisconsin Farm Bureau, Communicating for Agriculture, and a number of other farm organizations.

Last month, Mr. Chairman, I offered this provision as an amendment to the tax bill. I am pleased to say that you voted in favor of my amendment, and for that, I thank you.

Even though this is a relatively new proposal, we received 45 votes. It is my hope that, as the Finance Committee reviews tax legislation, it will consider including a farm asset rollover provision among proposals that expand on the existing IRA. This would help America's farmers and would help the economy by increasing national savings.

You are going to hear a number of different proposals here, Mr. Chairman. But I feel very strongly that we can reach and must reach bipartisan agreement on dealing with this important problem somehow. And I think we have got to reach it soon, not later.

This is not a Republican or a Democratic idea. We have got Republicans and Democrats testifying before you, and we had Republicans and Democrats both supporting the Kasten amendment with the 45 votes.

I think we have got to make the rest of America understand some of the problems that we understand representing farm States. But I look forward to reaching a consensus on these issues with your leadership. And, once more, I thank you for these hearings today.

[The prepared statement of Senator Kasten appears in the appendix.]

Senator DASCHLE. Well, Bob, thank you for your testimony. I applaud you, again, for your idea and the leadership you have shown in this area.

I followed the debate on the floor about a month ago with some interest, and it was on the basis of that debate that I enthusiastically supported the amendment on the floor.

You made reference to income averaging. The fact is, as you recall, in 1986 we eliminated income averaging. So, we really do not have the ability to use income averaging as a financial tool in any area, and it has really been one of those financial tools, those tax tools, the loss of which has been very detrimental to agriculture. So, this proposal as you say, brings it back to a certain degree, especially for those farmers who may need it the most.

Let me ask you this. I should know, and I do not. Do you put any cap on eligibility for this plan?

Senator KASTEN. Mr. Chairman, each spouse is limited to a rollover of $10,000 of farm gain for each year of farming up to a lifetime cap of $250,000, however there is presently no income eligibility cap.

Senator DASCHLE. All right. Listen, thank you again. I appreciate your testimony this afternoon.

Senator KASTEN. Thank you very much.

Senator DASCHLE. Our next witness is a good friend and someone I have worked with for many years. He also knows agriculture extremely well. We are pleased he could join us this afternoon. Congressman Jim Slattery, from Kansas. Jim, we will take your testimony at this time.

STATEMENT OF HON. JIM SLATTERY, A U.S. REPRESENTATIVE FROM KANSAS

Congressman SLATTERY. Thank you, Mr. Chairman. First, let me say that it is good to see you, and it is good to see you in the position that you are in. I commend you, Mr. Chairman, for taking the initiative to conduct these hearings.

As I was sitting here I could not help but observe that this is the kind of tedious, difficult work that is unglamorous, yet is so essential in the law-making process.

And I commend you for spending an afternoon listening to the different ideas under consideration in the Congress that I think are important to making the Tax Code more equitable and fairer for Kansas farmers, and farmers all over this country.

So, again, I commend you for taking the time, and commend you for your leadership in this area, also.

Senator DASCHLE. Thank you.

Congressman SLATTERY. I would like to point out that our colleague from North Dakota, Byron Dorgan, wanted to be with us today. He is unable to be here.

But Congressman Dorgan is really carrying the ball for us on this issue in the Ways and Means Committee on the House side. And, when I refer to the ball, I am talking about H.R. 1711, which Congressman Dorgan and I introduced last this year.

As a way of background, let me just observe that, under current law, a taxpayer, if he or she is aged 55 or older, can sell his or her principal residence and the first $125,000 in capital gains is exempt from taxation. That is the existing law.

When a farm is sold, however, the farmer must allocate the selling price between the personal residence, including the immediate surroundings and outbuildings relating to it, and the property used in the farm operation.

Under H.R. 1711, we propose that if a farmer who is over age 55 sells his or her principal residence, and also sells qualified farm property, he or she could exempt up to $125,000 of the total capital gain on the sale of the homestead from taxation.

The property would be considered qualified farm property if the taxpayer's family materially participated in the operation of the farm for at least three of the past 5 years. This legislation would become effective for taxable years beginning after December 31st, 1989.

Let me just be very brief in observing also that this legislation was included in H.R. 4210, which the Congress passed earlier this year. And, unfortunately, this legislation was vetoed by President Bush.

But, again, this was a very simple concept and one that I believe will make the Tax Code more equitable for family farmers all across this country.

And, again, just to reiterate, under existing law, taxpayers over age 55 are entitled to this one-time exclusion from their capital gains tax on the sale of their personal residence equal to $125,000.

I am suggesting in this legislation that this one-time exemption should be also extended to and made available to family farmers who sell up to 160 acres of qualified farm land as the legislation defines it.

And, by so doing, we would get away from this current situation that requires farmers to segregate the value of their house and few outbuildings in the country from the value of the land.

And I would just observe that, under the current situation, the houses in the country are worth, oftentimes, a mere fraction of what they were worth if they were located in town.

And this creates a fundamental inequity, as far as I am concerned. Because I think it is important for us to look at that 160 acres in the country as the homestead, in effect. And that is what this legislation proposed to do.

It has been estimated that the cost of this would be about $100 million a year over the next 6 years. So, it is realistic, I think, to look at this kind of a correction.

And when we talk about the need for capital gains tax relief, this is a very targeted approach that, in my opinion, will provide some very needed relief to a group of people in this country that, to date, as far as I am concerned, have not been treated fairly under the existing Tax Code.

So, I would be happy to try and answer any of your questions, Mr. Chairman. Again, I commend you for taking the time to hold these hearings here by yourself, and I commend you for your leadership.

Senator DASCHLE. Thank you very much for your testimony, Jim. Let me clarify something for the record, because I do not know if people understand this very well, and you would be an ideal person to address it.

When a house is sold in a small town in South Dakota, the value of that house is calculated, of course. And if the person selling the house is over the age of 65——

Congressman SLATTERY. 55.

Senator DASCHLE. 55. Excuse me.

Congressman SLATTERY. Yes.

Senator DASCHLE. They have a one-time capital gains exclusion. If a house with adjacent property is sold on the farm—and usually it is a house and adjacent property, as I understand it, and I would be interested in your clarification of that—it is only the house, not the adjacent property, that is subject to the exclusion, which makes it very difficult for tax calculation purposes, does it not?

Congressman SLATTERY. Absolutely.

Senator DASCHLE. It is almost impossible to separate out the house and its value from the adjacent property on which the house sits.

Congressman SLATTERY. The land.

Senator DASCHLE. But that is what somebody has to do. They have to make that calculation before they can determine the amount of the exclusion for which someone over the age of 55 may be eligible. Is that not correct?

Congressman SLATTERY. Absolutely. And I will tell you how this was brought to my attention. A constituent in Baileyville, Kansas was in the process of trying to sell his homestead to his son.

And, in the process, he learned that he had to segregate the value of the residence, the house, in effect, from the value of the land.

And, of course, the problem you get into in rural Nemaha County, Kansas, and I am sure the same is true in rural counties all over this country, is that the value of that house in the country, by itself, is generally a fraction of what it would be worth 20 miles away in a city.

And the problem you get into is that it is extremely difficult to determine what the value of that house is sitting out in a remote area of the country.

And it only makes sense, in my judgment, for us to evaluate the price of the residence in the context of a homestead, in the context of 160 acres, as we suggested in this legislation.

Senator DASCHLE. But you put a cap on it, do you not, of $125,000?

Congressman SLATTERY. We put a cap of $125,000.

Senator DASCHLE. That is right.

Congressman SLATTERY. And we further cap it by the 160 acre limitation.

Senator DASCHLE. Right. So, it is subject to the same exclusion as a house in town.

Congressman SLATTERY. Absolutely.

Senator DASCHLE. If you include the adjacent land, which is really part of the integral value of the property being sold here, all would be subject to that $125,000 cap?

Congressman SLATTERY. Yes. And the other observation I would make is that, historically in many of our States, like Kansas, and I would guess it is similar in the Dakotas, the State laws have historically acknowledged that the homestead is the 160 acres. So, if you had homestead exemption laws, for example, they would historically exempt the 160 acres not just the house.

So, what I am suggesting is that that concept should be applied to the Tax Code in this area and treat the sale of the homestead, the farm residence, in effect, the same as we would treat the sale of a personal residence in Topeka, or in Kansas City, or New York, or L.A.

Senator DASCHLE. Would you not say that in Kansas, as we find in South Dakota, the vast majority of farm homes that are now being sold are being sold by people over the age of 55, trying to find somebody within the family or somebody close by who may buy the farm and keep it together?

Congressman SLATTERY. Well, in fact, when you look at the average age of farmers in this country today, it is alarming to realize that the average age is above 55.

And it makes the point that you are trying to make, and that there are an awful lot of family farmers now that are over age 55, many of them over age 65, that are attempting to sell their farms or their residence in the country to a son, or a daughter, or to another family member, or to anyone that is willing to buy it, for that matter.

And, in the process, they learn that their entire homestead is subject to capital gains tax, unlike their brother or sister who may be selling their residence in the city. And that is the fundamental point that we are trying to correct with this legislation.

I would hope that if the Senate Finance Committee later this year moves any kind of a tax bill, that you, Mr. Chairman, would look kindly on this legislation and use your enormous persuasive skills to include it in any bill that might leave your body.

Senator DASCHLE. Well, I am a co-sponsor of a similar bill on this side, and I very much appreciate knowing the broad support that appears to exist in this House for this legislation. Thank you very much for taking the leadership to advocate on behalf of this proposal this afternoon.

Congressman SLATTERY. Very good.

Senator DASCHLE. Thank you, Jim.

Congressman SLATTERY. Thank you, again.

Senator DASCHLE. As Congressman Slattery indicated, Congressman Dorgan had originally intended to testify. Without objection, his statement will be made a part of the record at this time, as well as that of Senator Kassebaum, who also has expressed an interest in these areas and has a bill pending similar to the one that we have just been discussing. So, without objection, her statement will be made a part of the record as well.

[The prepared statements of Congressman Dorgan and Senator Kassebaum appear in the appendix.]

Senator DASCHLE. Senator Jim Jeffords, from Vermont, is scheduled to testify. And I see he is walking into the room as we speak. Jim, if you have your wits about you, we will take your testimony at this time, as well.

Senator Jeffords. I have got half of them, anyway. [Laughter.]

Senator DASCHLE. All right. Welcome. We are very pleased to have you come before the committee. I had the good fortune to work with you for many years on the House Agriculture Committee and enjoyed that opportunity immensely. I look forward to working with you on issues related to agricultural tax, as well.

So, we are delighted you are here, and invite you to proceed as you see fit.

STATEMENT OF HON. JAMES M. JEFFORDS, A U.S. SENATOR FROM VERMONT

Senator JEFFORDS. It is a pleasure to be here. I have enjoyed working with you and am amazed at the common interest we have between our States so far apart, between South Dakota and Vermont.

Again, I would like to bring to your attention an issue which we believe is an important one, and which we hope just a small modification of the tax law without too much of a ramification on the aspects of taxes could be of significant help in trying to help solve the problem. I have a statement. I would like to make that part of the record, if that is quite all right.

Senator DASCHLE. Without objection, that will be done.

[The prepared statement of Senator Jeffords appears in the appendix.]

Senator JEFFORDS. I will probably just proceed on the basis of the fundamentals of the issue. We all know that we have problems with wetlands in this country. The preservation of those wetlands is extremely important. It is extremely important because we have allowed so many of the wetlands to be filled in and to disappear. And the same is also true for undeveloped land, forest land, and whatever.

The bill that I have introduced, S. 887, is called the Wetlands and Greenspace Preservation Assistance Act. What it is trying to deal with is especially in the case of death and the transfer of property from one generation to another.

We have already recognized in the tax law that we ought to give special attention to farm lands and other kinds of land. What this bill does is broadens the means of trying to protect these lands into the area of wetlands and also greenspace lands.

Basically, what the bill says is that if you will subject these kinds of lands to an easement, the land will be not taxed at the highest and best use, but will be taxed on the value of the land with respect to the easement that is attached. Thus, the cost to the taxpayer would be considerably less in taxes upon the transfer at death, which would remove the incentive to sell these lands for development.

I think preservation of these kinds of lands are a very major part, for instance, of our endangered species dilemma, it contributes to landfill siting problems, significantly impacts on the activities allowed on Federal and other public lands. Deforestation, for example, is another land use problem. One nation's use of their land can affect not only their citizens, but also the world as a whole.

Closer to home, one of the main controversies surrounding, for instance, the James Bay hydropower project, is flooding of thousands of square miles of land. All of these problems have created pressure to preserve what the undeveloped lands we have left.

So, basically it is a relatively simple bill that would try again to expand existing farmland preservation programs to wetlands, as well as greenspace lands for the purposes of taxation at the time of death.

I know we do not have all the answers to resolve these conflicts, but I do believe that private property owners are entitled to certain rights and that we should not infringe on these rights unnecessarily without compensating the owner or the public benefit that results from environmental protection.

The continuing controversy over wetlands is evidence that we now have not yet figured out how to resolve these conflicting goals. One thing I am certain of is that our government now sends conflicting signals of environmental protection and development.

For example, today, the Environment and Public Works Committee began working up a bill to re-authorize the Resource and Conservation Recovery Act. One of the most controversial issues is recycling. To reduce the needs for landfills which cities often cannot site, cities are undertaking recycling programs. Unfortunately, in many cases it costs more to use recycled materials than virgin materials. Thus, the current proposal will require industries to recycle and re-use a portion of their product's packaging.

One reason virgin materials are cheaper for industries to use is that the Federal Government subsidizes the use of virgin materials. Thus, on the one hand, we are telling industry not to use virgin material, while on the other hand we are subsidizing virgin materials to encourage their use. The American taxpayer and consumer end up paying twice; once for each conflicting goal.

Conflicting signals are also sent in terms of land preservation. The government has regulations to discourage the development of wetland areas, yet, when calculating taxes on the same lands, the government requires that the land be assessed at the highest and best use.

To our government, highest and best use means development. The effect of our government's highest and best use is to basically encourage landowners to develop land or to sell land to pay the taxes. To me, the highest and best use of land is its natural undeveloped form, not as a condominium development.

The Federal Government is not the only level of government that sends mixed messages. Local governments often calculate property taxes in the same manner. This is most obvious when land is proposed for inclusion in national parks. Local governments express significant concern of the loss of this land for their tax rolls. Local government's often feel money is more important than greenspace or wetlands.

I do not propose to change the local property taxes, but we can change the Federal Tax Code. The approach contained in this legislation is the same as is currently used to protect the family farms from the tax assessor. The Inheritance Tax Code allows family farms to be assessed at their current use and not the highest and best use, providing that the family continues to farm the land for

at least 10 years. I propose the same approach for other undeveloped land.

I thank you for your attention in this matter. I know you will give it your deep consideration, and hopefully pursue these public policy changes. Thank you, Mr. Chairman.

Senator DASCHLE. Thank you, Jim, for your testimony. Let me just ask a couple of questions to clarify the proposal.

Senator JEFFORDS. Sure.

Senator DASCHLE. You are recommending or proposing a preservation easement for how long a period of time?

Senator JEFFORDS. Ten years.

Senator DASCHLE. Is it renewable?

Senator JEFFORDS. It could be, but such renewals would not be required under this act. A minimum of 10 years is required for the preservation easement.

Senator DASCHLE. A minimum of 10 years.

Senator JEFFORDS. Right.

Senator DASCHLE. And then, subject to a potential for an additional period of time.

Senator JEFFORDS. Right, but to receive the favorable tax treatment, only 10 years is required. And I have no problem if longer time is necessary to ensure preservation. I believe we picked the 10-year period because that is the present provisions with respect to the preservation of farm lands.

Senator DASCHLE. Would it be considered a charitable deduction?

Senator JEFFORDS. I am sorry.

Senator DASCHLE. Would it be considered a charitable deduction for tax purposes?

Senator JEFFORDS. No. It would just be a difference in land valuation, that the land valuation would be based upon the land subject to the restrictions on its use, and, therefore, its value would be decreased, at least to the extent of the time that it could be used for that purpose.

The valuation would be determined by the length of time that the—in other words, if it was perpetual, then that obviously would reduce the value of the land more than if it is only subject to a 10-year option.

Senator DASCHLE. So, the whole purpose would be to lower the estate tax?

Senator JEFFORDS. Lower the estate tax so that it can be preserved. Basically, that is it.

Senator DASCHLE. What if the heir fails to maintain the contract during that 10-year period of time, is there a recapture tax required?

Senator JEFFORDS. There are provisions to recapture the tax.

Senator DASCHLE. So, there would be a retroactive recapture tax, or would it be a tax that would be implemented as of the date the heir chooses not to——

Senator JEFFORDS. It is retroactive.

Senator DASCHLE. It is a retroactive tax. Very good. Well, I think it is an excellent idea. We have wetland concerns and problems in our State, and, I know, in the upper Midwest. We have got to find ways to resolve this matter.

You are using the carrot rather than the stick, and I think there is an appropriate place for both. I like the carrot approach much better myself, to the degree it works. This is an innovative approach, and I applaud you for it.

Senator JEFFORDS. Thank you very much.

Senator DASCHLE. Thank you for your testimony, Jim.

Senator JEFFORDS. Thank you, Mr. Chairman.

Senator DASCHLE. That concludes our series of Congressional witnesses. Our next witness is an official with the Department of the Treasury. He is the Acting Deputy Tax Legislative Counsel, Mr. James Fields.

If Mr. Fields can come to the table at this time, and anybody who wishes to accompany him, we will take his testimony.

Again, thank you for coming, Mr. Fields. We are pleased you could be with us. You have had the opportunity to hear proponents of various proposals that are currently pending before the Finance Committee. We have your written testimony. We invite you to proceed any way you see fit.

STATEMENT OF JAMES FIELDS, ACTING DEPUTY TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

Mr. FIELDS. Thank you very much, Mr. Chairman. The administration appreciates the opportunity to provide its views on the seven proposals that you are considering today.

The administration shares your concern for small farms and family farmers. We are very troubled by the statistics you cite and the statistics we have seen.

However, with respect to these specific provisions, we wish to evaluate them in the way you suggested, which is based on tax policy considerations and on revenue considerations, since we are constrained by the pay-as-you-go provisions.

In that light, we object to and oppose several of the provisions on both tax policy and revenue grounds. We have not done final revenue estimates; however, we have done preliminary estimates. If we took the package as a whole—and we realize that no one is proposing that, but just to give you an idea of the magnitude of the revenue costs of the entire package—we are talking about $3 billion revenue loss over the 5-year period going forward. We consider that to be a fairly significant expenditure without an offset.

If I may, I would like to go through briefly the seven proposals, and try to focus on the ones that we believe are most controversial, leaving to later questions those that may not be as controversial.

I would like to start with S. 710, the Aggie Bond proposal. The President's 1993 budget included an 18-month extension of the Aggie Bonds.

We continue to support an extension in the context of general legislation dealing with extenders of expiring provisions. We do not see it as appropriate to deal with Aggie Bonds separately; we should deal with all of those issues together.

Next, I would like to deal with S. 887, the Wetlands and Greenspace Preservation Assistance Act of 1991. The administration opposes this provision. The Code currently provides for chari-

table deductions for both estate tax and income tax purposes for the creation of permanent easements.

So, this proposal adds a tax benefit for certain 10-year easements but, unlike current law, it includes none of the protections that ensure that tax subsidized easements provide public benefit consistent with the policy of granting a charitable deduction.

The current Code and regulations make sure that the easements have social value; that the grantor does not benefit from the easement, and that there are means to protect continued preservation of the easement. The bill lacks all of those.

And, if I could briefly go through them, I think you can get a flavor for it. First of all, the bill lacks any public benefit requirement. Seemingly, any open space would qualify. It could be a rubble-strewn lot with no social value that would qualify for the bill to the extent that it provided advantages for estate planning purposes.

Second, there is no public access requirement. The public can be excluded from the property, the public may not even be able to see the property, yet it could qualify for the special valuation.

Third, the transferee need not be a charitable institution. Current law requires the transferee to be a charitable institution. From our reading, it appears that the bill would permit the owner of the property or the heir to transfer the easement effectively to a family member and they could continue to enjoy full use of the property, other than development, to the exclusion of the public.

Moreover, because we do not have a charitable donee requirement, there is no one to police the easement except the IRS. Under the current preservation easement system, the tension between the charitable donee and the grantor gives us at least some assurance that the easement will be maintained.

Lastly, there is no limitation on private inurement of benefit to the donor or the donor's family. Under current law, if the developer gives an easement in a land area, but his adjacent development appreciates in value as a result of the gift, his charitable deduction is reduced, which makes sense. There is no such reduction for private inurement of benefit in the bill.

For all those reasons, we are very concerned about this bill. Taken as a whole, the bill inadvertently creates an excellent estate planning device. And, for that reason, we oppose it. The revenue cost, as stated is about $800 million over 5 years.

Next, I would like to address S. 1045 and S. 1061, the Expansions of the Special Use Valuation Rules. In general, the administration supports expansion of these rules. We would like to expand the use of cash leasing by heirs, however, we believe that liberalization should be prospective only.

We believe that S. 1045 reflects the appropriate balancing between the need for flexibility for the family and the needs to really limit the special use valuation in terms of an immediate family unit and not in terms of allowing what start to appear like commercial transactions. But, within those confines, we think S. 1045 is very appropriate. We have previously testified in favor of expanding the availability of cash leasing.

Next, I would like to address S. 900, the Farm Debt Reform Act of 1991. Again, the administration opposes this provision.

This provision itself, though addressing a troubling problem, does not require financial difficulty or an inability to pay tax for the taxpayer to receive its benefits. Even solvent taxpayers receive the benefits of this provision.

The bill provides no benefits to any other taxpayers other than farmers, though many, many businessmen, small businessmen and otherwise, suffer very similar problems.

They are subject to renegotiation of their debts, they are subject to satisfaction of bank debts with property. Yet, this provision addresses only farmers. We feel, for that reason, it is very inequitable.

And, if you are going to start forgiving this kind of taxable income, a broader-based proposal would have to be considered. Of course, the revenue implications of such a proposal would be very significant.

Finally, and I think very importantly, this proposal draws an interesting distinction between sales of property to third parties and transfers to the bank in satisfaction of indebtedness. We think that distinction is going to result in some very bad incentives.

If I sell my property, whether under water or not, in the market I pay a tax. If, however, I transfer it, even if it is above water, to the bank, I do not pay any tax, which means the bank becomes the first best buyer of appreciated property in the farm community. We do not think, given what we have seen over the past several years, that that is the incentive that we want to create.

Finally, we believe the revenue estimates for this are very significant, approximately $1 billion, with more than half of that due to the retroactivity provisions.

Next, I would like to address S. 1130, the Asset Rollover Account provisions. The administration opposes this proposal. Clearly, this is not a provision designed to promote the survival of troubled farms, it is a proposal designed to assist exiting the farming business by seemingly very successful farmers. The troubled farmers we have been talking about do not have half a million dollars to invest in asset rollover accounts.

If these accounts were really intended to assist small farmers, we would expect to find some form of wealth restrictions, some form of limitation on availability, but there are none. The only restriction is a maximum contribution amount of $500,000.

Moreover, we think it is inequitable to provide this benefit only to farmers. Why should this group, as opposed to any other family business, be able to liquidate their business and receive this benefit? They would have a preferred savings and investment vehicle available to no one else.

Finally, under current law, to take advantage of the variety of qualified plans, savings and investment vehicles, a farmer who employs other individuals and who has done very well must also provide benefits to the employees.

This proposal means that a farmer could have a preferred savings and investment vehicle without providing benefits to employees. This is a benefit unavailable to any other small or medium-sized businessman in the country. We think that is inappropriate. Again, the overall revenue cost of this proposal is about $800 million, and we consider that to be fairly significant.

The last item is S. 2202, which is the Extension of Section 121 Benefits to Adjoining Farm Land. The administration opposes this, but would consider suggestions and ideas regarding deminimus rules to reduce conflicts between the Service and taxpayers over what is the farm and what is the principal residence.

Simply assuming that all of the farm land is part of the principal residence we feel is inappropriate. But, if there are controversies arising because of the line being drawn, we are willing to consider various deminimis rules to deal with that.

Basically, we see this proposal as being inequitable. It would provide farmers an opportunity that no one else has to essentially defer or eliminate gains on business property. There are many individuals who do not get the benefit of the full $125,000 exclusion.

Are we to say that renters should get to exclude their business property, that mobile home people should get to exclude their business property because they cannot enjoy the $125,000 exclusion? We do not think that is appropriate policy here, and we oppose the provision. Thank you. I am willing to take questions.

[The prepared statement of Mr. Fields appears in the appendix.]

Senator DASCHLE. Thank you, Mr. Fields. Let me just pick up where you left off. You are not from a rural community, are you?

Mr. FIELDS. No, I am not.

Senator DASCHLE. All right. Well, in rural communities, I think it is safe to say that in just about every State I have visited, the home place when you are on a farm is not the home, it is the home place and includes the contiguous land the home is on. It really is not divided.

When someone sells the home place, they are selling the area around it. It may include the buildings, it may include the land. But, in any case, it is looked upon as a unit very different from what you have in a town where you have a house.

In Washington, for example, $125,000 may be a garage. It may not be much more than just that. So, it is all related, of course, to the demography and certainly the conditions that one is considering. But trying to differentiate between a building which may be the house and the home place is almost impossible.

I do not know if you had experiences in your work where that issue has come up, but, clearly, that is the problem. And by putting a cap on it, which I think you would have to admit is substantially lower than the value of any house in Washington, DC, we are not really talking about a windfall here.

Mr. FIELDS. Well, first, I do not have personal experience with the allocation process. We have begun some discussions with the Internal Revenue Service as to whether there are, in fact, extensive controversies about this, whether taxpayers are having a fight with the Service in this allocation process.

On a very preliminary basis, the answer has generally been no. That farm land, separately, is sold on a regular basis in the areas, and, therefore, it is relatively straightforward to appraise the land separate from the house.

Perhaps the unfortunate consequence of that is that the house does not have much value, as you described, whereas if that same house was moved into Georgetown, it would. However, that is true

of many, many, many Americans whose homes do not appreciate, or who are not homeowners, or who live in a mobile home.

The leap from there to say that because they are unable to benefit from the $125,000 exclusion on their principal residence, that they should be able to also exclude $125,000 of business property, we believe to be inappropriate.

Senator DASCHLE. Help me, if you can. When a house is sold in a town, is the property upon which the house is located part of that calculation for exclusion purposes?

Mr. FIELDS. Actually, if you have a part of your house that is, for example, used for business purposes——

Senator DASCHLE. No, no. I am not talking about for business. I am just talking about the lot.

Mr. FIELDS. All right. If there is no business use of that property, no.

Senator DASCHLE. The lot the house is located on——

Mr. FIELDS. If there is no business use of the property, no. But, if you had, for example, an adjacent lot that was undeveloped, I do not know the answer, but I believe that that is separately dealt with, that that is not part of your principal residence. But I am not sure of that. But the basic answer——

Senator DASCHLE. I am almost sure. Could you check, or maybe somebody who is accompanying you correct this?

Mr. FIELDS. No, they could not.

Senator DASCHLE. They would not know either?

Mr. FIELDS. I do not believe they will know off the top of their head, sir. No.

Senator DASCHLE. Well, I am told, and let us make sure for the record that I have this right, that a house that has a lot—and obviously, every house has a lot—that that lot is included as part of the calculation for exclusion purposes.

Mr. FIELDS. Oh, yes. The lot on which the house sits is excluded.

Senator DASCHLE. Well, that is what I was asking.

Mr. FIELDS. Absolutely. No. I am sorry. I was saying if there was an adjacent property or a business property, that would be excluded.

Senator DASCHLE. No, no, no.

Mr. FIELDS. I am sorry. Yes.

Senator DASCHLE. Well, so, in essence, that is what we are saying on a farm. I mean, you have got a lot. A lot is the contiguous property upon which the house sits.

But current tax law precludes the "lot" from being included with respect to a farm. Obviously, a lot has a different definition in a farm setting than it does in a town, but the principle remains the same.

The contiguous land around a house ought to be considered, for purposes of tax treatment, the same as land in a town. And, so, I have difficulty understanding why the tax treatment would be different in a rural setting than it is in a town.

Mr. FIELDS. If, in town, I used my garage as an auto repair shop and deducted it, I would not be able to take any gain associated with that portion of my house, and apply the $125,000 exclusion to it.

To the extent that there is business use of the property, that property is excluded. Here, what you are describing is the whole farm really includes business property.

It includes out-buildings, tractor sheds, the works. Those are business properties which, traditionally, are not the residence and are deductible and generate depreciation deductions and the like.

Senator DASCHLE. Well, but it is not just business. When you are on a farm, I mean, it may be business, but it is part of the definition of that particular farm unit that goes beyond just business. It goes to the cultural and historical and traditional appreciation of what that farm unit actually is.

In any case, let me ask you something with regard to special use valuation and cash leasing. I understand it, you do not oppose limited extension of the right to cash lease, and you say S. 1045 represents a reasonable approach. But I was unclear as to your position with respect to S. 1061. What is your position on S. 1061?

Mr. FIELDS. We would generally oppose S. 1061 as going too far. What we think the basic way to look at the problem is, and we have testified in the past to this effect, is that essentially a qualified heir should be able to cash lease to any other person, member of the family, that the decedent would have been able to directly devise his property to, and that property would have been eligible for special use valuation.

So, if the property had gone directly to that person and property would have been eligible for special use valuation in the hands of that person, we think it makes sense that the heir can cash lease to that person. And that defines a family narrowly.

We believe that S. 1061 goes far beyond that, and gets a little complicated. But, essentially, S. 1061 means that the property could be cash leased not merely to the family of the decedent, including spouses and in-laws, but also to the extended family of the decedent's heirs.

So, you could have a situation which we think gets fairly tenuous, for example, where the stepson of the decedent leases to his grandniece's spouse. I mean, it may sound farfetched, but the current definition of family is very broad and you begin to get fairly broad classes of people, who do not seem to be in the immediately family, covered by S. 1061.

Senator DASCHLE. What about brothers and sisters?

Mr. FIELDS. Brothers and sisters would be covered by S. 1045, and we think that is appropriate. Brothers and sisters should be covered. I think it is just a question of line drawing.

But it seems to us that all of the complaints we have heard deal with fact patterns that are somewhere in the range of S. 1045 and potentially a slight expansion of it. But it is not necessary to go to S. 1061, which may, in some cases, take in large numbers of people.

Senator DASCHLE. But is family member not very narrowly defined in the Tax Code today?

Mr. FIELDS. No. For this purpose, Mr. Chairman, we believe it is very broadly defined because the intent was to try and allow a fair number of heirs to be able to use it.

Senator DASCHLE. Well, actually, the fact is, though, Mr. Fields, we have a case in South Dakota right now where brothers and sisters are excluded.

Mr. FIELDS. Absolutely. And that is the cash lease problem.

Senator DASCHLE. Well, that is what I am talking about.

Mr. FIELDS. Yes.

Senator DASCHLE. Where is it broadly defined?

Mr. FIELDS. Well, the relevance of family member is who is a qualified heir, who may receive directly. We believe that to be a fairly broad term. It includes parents, grandparents, brothers, sisters, all descendants of brothers and sisters and the particular party, as well as spouses. The problem is, that we cannot cash lease between those people.

Senator DASCHLE. That is right.

Mr. FIELDS. And we agree that there should be some cash leasing.

Senator DASCHLE. So, you think the same broad interpretation for cash leasing ought to exist?

Mr. FIELDS. As long as the lessee could have been a qualified heir of the decedent, so brothers and sisters would qualify, we think that is fine. What we are not comfortable with is an in-law of a spouse, which is where you get in S. 1061. You start to get some very, very extended family members.

But I think we are basically in the same place, it is just a question of where we draw that line. I am convinced that we would be able to deal with the problems.

Senator DASCHLE. Let me ask you about S. 900. You say that it would cause a significant loss in revenue, and, yet, you are dealing with farmers, who, by definition, have no capacity to pay revenue today, pay taxes today. Is it not true that you are actually losing revenue with these people today?

Mr. FIELDS. Well, there are two classes of people subject to the rules. One class are insolvent farmers. What we find most troubling is the extension of Section 108 of the Code under this provision to solvent taxpayers, taxpayers, who, by definition, have more than enough cash to pay their taxes. That is where the revenue is, Mr. Chairman. It is not in the blood of the insolvent.

Senator DASCHLE. But if you are talking about a lot of farmers—and I am told that it may be as high as 25 percent who are insolvent today—who fit this category—what alternatives would you suggest they consider?

Mr. FIELDS. Well, first of all, for cancellation of indebtedness income purposes, there are two pieces here. The cancellation of indebtedness piece——insolvent farmers are already taken care of.

The Code protects them on cancellation of indebtedness income. If they are insolvent, the income first reduces tax attributes, and, then, if they run out of attributes, the remaining income is forgotten, it is gone.

With respect to gain, they are not protected, but nor is anybody else when they are insolvent and they sell property at a gain. No one—no one in this room, no small businessman—is protected from that.

The only thing you can do in that circumstance, if you do not have the cash to pay your tax and you are not bankrupt but you

are insolvent, is to enter an agreement with the Service. The Service has the authority, and, in appropriate circumstances, enters into installment agreements and defers the tax if the taxpayer can prove hardship. The Service is actively doing that when appropriate.

But, you are absolutely correct, Senator. In those events, there is a tax liability unless you go bankrupt, at which point the bankruptcy court sorts out which creditors get what.

Senator DASCHLE. But I am told that, even in bankruptcy, many of these debtors are still subject to tax debt; that they are not exempt or absolved from their tax liability. Is that not correct?

Mr. FIELDS. That can be true, yes. But, again, when we are talking about sales of assets, that is true of anyone. It is not restricted to farmers, it is true of you, me, anyone who gets into trouble.

Senator DASCHLE. Well, Mr. Fields, I really appreciate your coming to share the administration's position with us this afternoon.

My staff may have talked to you about this. We would love very much if you could enter into a discussion with some of our witnesses following their testimony if your time permits.

Mr. FIELDS. Yes.

Senator DASCHLE. We would like very much for that to be made part of the record, as well. Can you do that?

Mr. FIELDS. Yes. We can stay for an hour or so, if that is helpful.

Senator DASCHLE. Great. All right. Thank you. We will bring them to the table at this time.

Mr. FIELDS. All right.

Senator DASCHLE. I appreciate very much your testimony.

Mr. FIELDS. Thank you very much.

Senator DASCHLE. Our panel consists of Sarah Vogel, the commissioner of agriculture from North Dakota; Richard Dees, capital partner, McDermott, Will & Emery, from Chicago; William Greiner, the executive director of the Iowa Agriculture Development Authority; Brad McNulty, a partner from McGladrey & Pullen, from Rapid City; and David Saxowsky, associate professor of agricultural economics from North Dakota State University. If they will come forth, we will take their testimony at this time.

Sarah, we are pleased you are with us in yet another hearing. We appreciate very much your willingness to come all the way from North Dakota. I do not know that there is a better commissioner of agriculture or secretary of Agriculture in the country at this time.

You certainly have fought the battles and understand these issues as well as anybody I know. We are pleased you are with us, and we would invite you to proceed at this time.

STATEMENT OF HON. SARAH VOGEL, COMMISSIONER OF AGRICULTURE, STATE OF NORTH DAKOTA, BISMARCK, ND

Commissioner VOGEL. Thank you, Senator. I am very pleased to be here today to testify on this very important issue.

I have prepared remarks and I would like to have those just inserted in the record, and, instead, today, bring out some of the practical realities that face farmers in North Dakota, and, I believe, throughout the United States.

[The prepared statement of Commissioner Vogel appears in the appendix.]

Commissioner VOGEL. In North Dakota, we have a service called The Ag Mediation Service. It has been around since 1984. We have dealt with at least a quarter of the farmers in our State.

At the present time, we have over 800 farmers that we are working with, and as many as 1,600 will be with us shortly because Farmer's Home will soon be sending out another package of restructuring applications under the Farm Credit Act of 1987.

In this program, we have 33 negotiators and mediators who work hand-in-hand with farmers all over the State. The negotiators and mediators tell me that the IRS problems faced by distressed farmers is the number one problem that they encounter.

In many instances, farmers and lenders are able to work out win-win solutions, solutions in which the lender may get a portion of the property back, the farmer may be able to keep the homestead free and clear, and keep some of the debt.

Frequently, they work out an arrangement that is satisfactory to the farmer and satisfactory to the lender where they are both better off than they would have been if there were a foreclosure or a bankruptcy.

Only they find that, should the farmer and the lender go forward with this arrangement, they run into the IRS problem, which throws a monkey wrench into the arrangement.

Now, I think many people might assume that many of the farmers whom this occurs to are farmers that bought land in the late 1970s, early 1980s when land values were at their peak. That is not the case.

This is, for the most part, an older farmer problem. The typical farmers who encounter this problem are in their mid-to-late 50s. They cannot keep on farming any longer. They have decided to throw in the towel, fully or partially. And the IRS issue create serious difficulties for them.

One thing that happens on occasion is that if the farmers are in their late 50s, they will seek to postpone the day of reckoning until they can qualify for Social Security instead of cleaning up the issue with a lender directly.

The IRS cannot offset Social Security payments; they can offset ASCS payments and other types of income. So, the farmers basically wait until they can go on Social Security.

Generally, farmers receive the lowest amount of Social Security that is available. They then move into town and apply for low-cost housing, fuel assistance, food stamps, and so on. And it is a very, very undignified way for us to treat these people who have worked very hard all their lives.

At other times, they may file a bankruptcy hoping that the bankruptcy estate will carry the taxes. However, we sometimes find that many bankruptcy trustees simply abandon the property and the farmer is stuck with that liability.

Sometimes, the farmer will go out of business, incur the tax liability, and just let that liability exist until the farmer dies. And, again, that is a very harsh way to treat these people who have worked very hard.

I was interested in hearing the comments of the administration witness, who was talking about farmers versus other kinds of business. I have attached to my testimony a chart of the incredible rise and then fall of land values and property values for farmers.

This sudden shift in property values did not happen to lawyers, accountants, doctors, shoe-shine businesses, and so on. This was something I think that happened to farmers and only farmers.

Another factor is that it has been government policy that farmers live and work on their land. You could not get a homestead unless you lived there, built a house, and plowed the land or planted trees and farmed it.

Farmer's Home does not make loans to absentee farmers, they have to live there. Farmers businesses are different from in town businesses. The farm and the home are connected. They are intertwined. It is one and the same. And, for the most part, lenders do not put any value on the farm house unless it is in connection to the farm land.

I also support S. 1061. I will conclude my comments and would be happy to take any questions.

Senator DASCHLE. Thank you very much, Sarah. Mr. Greiner.

STATEMENT OF WILLIAM GREINER, EXECUTIVE DIRECTOR, IOWA AGRICULTURE DEVELOPMENT AUTHORITY, DES MOINES, IA

Mr. GREINER. Thank you very much, Senator. I appreciate the opportunity be before you today. I will brief my statement, and I would like to ask that it be placed in the record.

Senator DASCHLE. Without objection, the full statement will be made part of the record.

[The prepared statement of Mr. Greiner appears in the appendix.]

Mr. GREINER. Thank you. I want to appear here to support S. 710, which is sponsored by Senator Charles Grassley, which calls for the much needed permanent extension of tax-exempt Small Issue Private Activity Bonds, more commonly referred to as Aggie Bonds.

And, as Senator Grassley stated, Iowa has a highly successful Beginning Farmer Loan Program, and the continuance of the program is dependent upon this extension of the sunset. Iowa was the first State to offer a program whereby tax-exempt bonds would be utilized for agricultural projects. And we have operated a program since 1981 under which an individual bond is issued for each loan approved by our board.

Now, the Iowa program is highly targeted in that an applicant must be a first-time farmer, and, under Federal guidelines, a first-time farmer is a person who has never owned any substantial farmland.

And a beginning farmer, under the State of Iowa guidelines, and that is a person who has a net worth of $200,000 or less, including spouse and minor children.

It should be noted in the beginning that one of the important features of the program specifies that in the event of default on a loan, neither the Federal Government or the State authority is liable for any damages.

The principal and interest on the bond are payable solely by the beginning farmer and do not constitute an indebtedness of the Authority, the State, or the Federal Government, or a charge against their general credit or general funds. And since the beginning of the program, there have been very few defaults.

Since the first loan was made in Iowa in 1981, the authority has financed 1,288 loans totaling almost $110 million.

Unfortunately, the authority did not keep a record of the total number of acres financed during the first 4 years of the program, but since 1985, a total of almost 83,000 acres have been financed. It is estimated that the number financed have been well in excess of 115,000 acres.

The calendar year 1991 was the best year ever for the Iowa program, with 287 loans being closed, for a total of more than $26 million. This includes the financing of 23,683 acres of Iowa farmland, plus numerous buildings, equipment, and livestock used for breeding purposes.

Calendar year 1992 is off to a very good start, with 44 loans closed thus far, totalling over $4 million. And we have financed 4,752 acres of land this year. Our average size loan in Iowa is approximately $86,000.

Other States have experienced similar successes with Aggie Bonds. As an example, Illinois has been and continues to be highly successful. It issued $11 million in Aggie Bonds in 1991 and has a total of more than $131 million.

Colorado issued $10 million in 1991; Kansas, $9 million; Nebraska, $6 million; Missouri, $4 million. And the State of Minnesota started a new program in 1991 and began issuing in the latter part of the year and issued $400,000. Kentucky was active, closed approximately $600,000 in loans. So, the program is going very well.

The program in Iowa has been copied by many other States during the last ten year. As a result, more than 4,200 first-time beginning farmers have been assisted with their purchases.

I might add that the State of South Dakota has called us several times to inquire about our program, and is interested. We have also received inquiries from South Dakota farmers about financing some of their projects, which we cannot do if they do not live in Iowa. And we have also received inquiries from bankers in South Dakota.

In Iowa, the largest purchaser of Aggie Bonds are commercial banks. And, currently, the interest rate on our bonds with banks are running about 75–85 percent of the banks' in-house prime, base, or agricultural rate, and generally falls some two to four percentage points below the conventional rate.

I want to close by saying that Aggie Bonds have been and continue to be plagued by the constant threat of termination. There have been four sunset dates for Aggie Bonds in the Federal Tax Code in recent years: December 31, 1989, September 30, 1990, December 31, 1991, and, now, June 30th of 1992.

I would like to submit that working around these sunsets is a waste of precious time to the various authorities administering the program, the lenders and borrowers using the program, and, cer-

tainly, Congress expends too much time contemplating the extension of this type of financing each year.

We all need to direct our creative energies toward making the program better and more usable rather than debating the sunset issue each year.

We need the help of your subcommittee to support S. 710 to remove the sunset date for Aggie Bonds entirely. Aggie Bonds work and are being used for the purposes intended by Congress and the General Assemblies of the respective States.

I again encourage you to support S. 710 to permanently extend the sunset and allow Iowa and other States to go forward with our missions of assisting first-time farmers with their credit needs. The country will be a better place as a result. Thank you very much.

Senator DASCHLE. Thank you, Mr. Greiner. I appreciate very much your testimony. You make a very compelling case. Mr. Saxowsky.

STATEMENT OF DAVID M. SAXOWSKY, J.D., ASSOCIATE PROFESSOR OF AGRICULTURAL ECONOMICS, NORTH DAKOTA STATE UNIVERSITY, FARGO, ND

Mr. SAXOWSKY. Thank you, Mr. Chairman. I have a written statement that I would like to have as part of the record.

Senator DASCHLE. Without objection.

[The prepared statement of Mr. Saxowsky appears in the appendix.]

Mr. SAXOWSKY. Thank you. I appreciate the opportunity to address S. 900 this afternoon, the Farm Debt Tax Reform Act of 1991, and I will focus my comments on that legislation.

There are several points that I would like to emphasize. First of all, when we think about the farmers that will be going through debt restructuring or reorganizing their farm businesses in the future, it is not farmers that will become delinquent for the first time at some future time.

These farmers are already delinquent. They have been delinquent for a number of years, but they have been, for one reason or another, reluctant to restructure their debt.

And, as I will point out in a few moments, some of that reluctance is due to the tax consequences. So, as we think about S. 900, it is not limited to farmers that will become delinquent for the first time at some future date.

I would like to re-emphasize what the Commissioner has already indicated, and that is that this is a major tax consequence for our mid-career, low equity farmers; people who have been in the industry for 15–20 years, or longer.

This is not the same problem for those people who have been in the industry for less than 15 years. Again, we are looking at primarily the mid-career, low equity farmers that are facing the type of tax consequences that are being addressed by S. 900.

The taxable gain that we are looking at with S. 900 is not limited to farmers that are leaving the industry, nor limited to farmers that are simply trying to restructure within the industry. Bankruptcy is a possible alternative for both of these groups of farmers, the Chapter Seven liquidation.

Unfortunately, that does not seem to resolve the tax problems because of the abandonment issue, which we have already alluded to. That is, when a farmer goes into bankruptcy in Chapter Seven, he may find that the bankruptcy trustee will abandon the property because there is no value in that property to the bankruptcy estate.

At this time, tax laws are not clear as to who really pays the taxes when that land is subsequently abandoned and then liquidated for the resolution of debt obligations.

Even though the bill we are looking at today does not directly address the bankruptcy issues, these bankruptcy issues are a consideration because they clearly demonstrate that there is little alternative for these farmers in terms of finding ways of reducing their tax obligations when they arise from restructuring or liquidating a portion of their farm business.

Likewise, these farmers are with low equity. The limitations of the bill assures that they are being targeted. These individuals do not have the resources to pay the taxes.

Consequently, the tax implications of this type of legislation, the tax revenue for the Federal Government, probably is not as great as it might appear at first blush.

I would argue and I would suggest that we carefully look at whether or not these farmers are going to have an opportunity to pay these taxes if the current law is retained as it is.

I think a more significant impact that needs to be recognized by this subcommittee is that farmers are reluctant to go into restructuring their business when they have this uncertain tax obligation being held over their head.

I think if we clarify some of these tax issues, the farmers, working with their creditors, are going to be more interested in resolving their delinquent debts, and, that with this certainty, will have a better opportunity to plan how these resources, our land and our capital, will be used in the future.

There are going to be alternative uses and there are going to be alternative users within the Ag industry. This legislation has a potential of rectifying some non-neutral tax law at this time.

My experience in working with farmers, as well as dealing with practitioners in our States, reinforce my understanding that the issue of taxable gain remains a problem for the farmers who are restructuring their business.

In a conversation last week, one practitioner emphasized to me just as an example that farmers are staying in the industry longer than they wish, or than they perhaps should be, because of the unacceptable tax liability.

I would conclude by making the statement that the financial restructuring that we had experienced in agriculture is perhaps at a lower rate than it was several years ago, but business reorganizations are going to continue to occur into the future.

We expect that the restructuring will occur for farmers that are currently delinquent with their debt, or that they will become delinquent in the future for various economic reasons.

This problem, which has impacted thousands of farm operators since 1986, we do expect to continue into the 1990s. Thank you. I would be happy to answer questions.

Senator DASCHLE. Thank you, Mr. Saxowsky. Mr. McNulty.

STATEMENT OF BRAD W. McNULTY, PARTNER, McGLADREY & PULLEN, RAPID CITY, SD

Mr. McNULTY. Mr. Chairman, thank you for the opportunity to provide oral comments, as well as written testimony on this issue. I would like to speak briefly on each of the three topics and comment on how our certified public accounting practice in South Dakota has dealt with these three issues.

The first topic is the first-time farmer assistance, S. 710. The concept behind this bill is a very desirable goal. The cost of borrowing money is an often-discussed topic when I meet with my agricultural clients. It is common that they mention the excessive costs of borrowing as a large item of cash outflow. They would like to do whatever they can to lower that.

For first-time farmers, due to the large capital requirements of farming, be it for land, equipment, or livestock, it takes a significant amount of money to get started in the business. It is not uncommon for them to have a $200,000–$400,000 loan liability. Anything that could be done to provide a rate reduction would be greatly desirable for these first-time farmers.

I believe that the program needs expansion. As was previously mentioned, South Dakota has been questioning Iowa on how the operation works. South Dakota currently does not issue tax-exempt bonds.

Maybe permanency in the program would help a rural State like South Dakota become more interested in proceeding with issuing these tax-exempt bonds, knowing that the program would not be terminated in the near future.

The second topic is transferring the farm to children in S. 1045 and S. 1061. When Section 2032A was originally adopted, it was meant to help ease the estate tax transfer liability and help overcome that obstacle to the transfer of the farmland to children.

Since it was originally introduced, it has been amended several times to help make its provisions available to more individuals. I think it is time that it be amended again.

It is common that more than one brother or sister to inherit farmland, and it is common that only one of the siblings may operate the farm and the others are non-operators.

The current provisions essentially provide for the use of a crop share arrangement between siblings, and siblings often do not work well together. They may not trust each other. The operator may not want or appreciate input from the non-operating brothers and sisters.

In our practice, we continue to advise our clients to not use cash leases, but to be sure they use crop share arrangements, due to the disastrous consequences of using a cash lease.

Some of them fail to see why they need to use the crop share arrangement when a cash lease would be more suitable to their needs. The bills would both allow use of the much-needed cash leases among family members.

I prefer the broader definition of S. 1061, which uses the qualified heir definition, over S. 1045, which uses a more restrictive definition. The broader definition provides additional capabilities for improving the transfer of farmland, as is the intent.

The third topic the capital gain and debt relief issue. This was an area in which we saw a great deal of activity during the period 1986 through 1991.

Due to the agricultural financial crisis, we saw many instances of agricultural operators entering into debt work-outs with their lending institutions.

Some of them were straight debt write-downs, which the current tax provisions handled very well. Others involved the transfer of land, equipment, or livestock as part of the work-out.

The second type of transaction has two-part reporting; part capital gain and part discharge of indebtedness.

S. 900 would permit qualified taxpayers to exclude up to $300,000 worth of gain for this type of transaction. It would help mitigate the current tax consequences for those eligible to use the provisions outlined in the bill.

The provisions are available both for bankrupt and insolvent farmers, as well as farmers who fall under the qualified discharge of debt provisions. The bill contains a needed rule change, and I urge its adoption.

[The prepared statement of Mr. McNulty appears in the appendix.]

Senator DASCHLE. Thank you very much, Mr. McNulty, for your testimony. Mr. Dees.

STATEMENT OF RICHARD L. DEES, CAPITAL PARTNER, McDERMOTT, WILL & EMERY, CHICAGO, IL

Mr. DEES. Thank you. My name is Richard Dees. I am a capital partner at McDermott, Will & Emery in Chicago. I have been interested in special use valuations since I was a law student at the University of Illinois, working for the AgEconomics Department.

Although not required by statute, the IRS values family-owned businesses and farms at its sale or liquidation value, if that is higher, for estate tax purposes.

With an estate tax of up to 60 percent, this means that the estate taxes can actually be higher than the value to the heirs if they operate the farm.

This creates a perverse incentive for the next generation to sell rather than operate the farm or business. The beneficiary of that incentive is the real estate speculator, the wealthy investor, or the big corporate competitor.

This perverse incentive has been limited by Congress since 1976, to some extent, with respect to family farms, allowing up to a $750,000 reduction in value for farmland that meets strenuous predeath qualification tests, and, if the farmland is converted or sold, or the family quits farming, a substantial recapture of estate tax benefits recurs.

The substantial drop in farmland values in the 1980s previously testified show that this was a particularly important provision. So, far, so good.

But then something went terribly wrong with 2032A. Despite the fact that the rules were structured so the family farmers practically qualified without any estate planning efforts or trusts like they might have to do for other benefits, the IRS started using

technicalities to deny deserving farm families benefits intended by Congress.

The courts have rebuked the IRS. This Congress has acted in 1981, 1984, and 1988 to liberalize and overcome some of these technicalities.

Yet, with respect to two issues that I want to discuss today—the qualified use test and the election requirements—the courts have felt constrained by the legislative history from liberalizing these statutes and have refused to help family farmers.

The first problem I want to discuss is the IRS qualified use test. And, Senator Daschle, you are familiar with that, from a problem that the Kretschmar's have had in South Dakota. Unfortunately, they could not be with us here today.

Their three sisters inherited the farm from a mother who had died. The three sisters rented to the husband of one of the sisters, cash rented. This was done back in 1980, before anyone had even heard of the qualified use test.

Seven years later, the IRS sent out a questionnaire, and, of course, these farmers being truthful, the way farmers usually are, sent back and said, yes, we continue to farm it and the family cash leased to each other.

They went back and assessed a $54,000 recapture tax with penalties and interest more than twice the amount of the tax.

They have even assessed it with respect to the wife, who rented on a cash basis to her husband, saying even that, even though the money was co-mingled together and they operated the farm jointly, that they had a problem.

In the past, I have talked about the policy reasons for the change. I would like to address some issues today that people raise in terms of why this relief should not be granted.

First of all, some people say that family members who are not farmers may benefit from special use valuation if this change is made.

From the very beginning in 1976, Congress recognized that farm owners did not want to disinherit their children who were not farming. And so, they set up the touchstone of material participation.

As long as one family member of the qualified heir continued to farm, then that was sufficient. I heard the government statement today, which would impose a second level of tests for qualified use for these persons.

In other words, it would say that you had to be a family member of the decedent and a family member of the qualified heir, which would create two different tests. We should go back to the only test that Congress intended to put into the law, and that is that family members, as long as one is materially participating, is sufficient, and not this artificial qualified use test.

Some have suggested that this will allow dynasties to continue. Nothing could be further from the truth. The definition of the family farm member prevents that from happening.

Some say that this relief should not be retroactive, and at one time I would agree as to closed cases. However, we are in a situation here where Congress has essentially opened the door a few times and let a few people in, and said, it has cynically been sug-

gested in the legislative history, closed the door for everybody else. Because the courts have looked at the legislative history that existed and refused to allow relief.

Finally, I have included a chart that goes through the history. Some have said that this provision has been in the regulation since 1979–1980.

If you look at it, notice a Treasury decision 7786 that was entered. Congress repudiated its own position as to cash rents among family members and did not change the language in the regulation because it was suggested as being unnecessary.

I have some other suggestions that would improve 2032A, and I offer them in my written statement. Thank you.

[The prepared statement of Mr. Dees appears in the appendix.]

Senator DASCHLE. Well, Mr. Dees, thank you very much for your very enlightening testimony. I appreciate having a chance to receive it this afternoon.

As you alluded to, the farm couple in South Dakota is fairly representative of a lot of farm families that are experiencing the problems that have been addressed in the testimony this afternoon.

Let me ask Mr. Fields if he could come to the desk at this time, and maybe we can get into a little bit of a discussion. Mr. Fields, as he is coming up, as you all heard in his testimony, said, look, if it is available for farmers, it ought to be available for others, as well. That was the reason he gave for opposing several of the bills this afternoon. What about that, is that a legitimate reason for opposition to the legislation we are considering this afternoon for farmers? Sarah.

Commissioner VOGEL. I do not think so. I think that there are special issues and special problems that face farmers: First, their home and their business is intertwined; second, they are subject to macroeconomic forces to a greater degree than almost all other businesses, as illustrated by the exhibit to my testimony.

I also disagree with the administration's estimate of $1 billion. The bill is very clear that it is limited to very low-income farmers and that at the resolution of the restructure the farmer cannot have assets worth more than $25,000 or 150 percent of the tax liability.

My experience is that you can not get blood out of a turnip, and that $1 billion that they are talking about as a loss, for the most part, is just myth. Furthermore these people cannot move into a different occupation, for the most part.

Senator DASCHLE. Anybody else wish to comment on that? Mr. Saxowsky.

Mr. SAXOWSKY. Yes, I would like to. Thank you. As much as I try to emphasize to people in my State that farming is a business, it is still an industry that has some characteristics unique from other industries.

As the Commissioner has indicated, and as we are all well aware, various forces caused our land values to rise rapidly throughout the 1970s and into the early 1980s. Very similar forces, only the reverse direction, caused our land values to drop significantly the following years.

This rapid rise and fall in land values, I do not think, has been experienced in other industries on their major assets to the same extent that agriculture has endured it in the last 15 years.

During that time of rapid rise and fall of this major asset for this major industry, we had all sectors of the industry—farmers, lenders, government, and so forth—looking at the increases in these land values and basing long-term decisions on these rapidly rising land values. When the land values began their reversal, the declines, we were caught in a situation where we had debt to service without the income to meet those obligations.

This is why we are facing the consequences we are looking at right now, and that we have looked at for the last several years, and that I think we will—and I am confident we will—be looking at in some form in the future.

Senator DASCHLE. What about that, Mr. Fields? I think what they are saying is that there are unique features to agriculture, as there are unique features to other industries.

I am reminded, as I listen, that we have an oil depletion allowance which is unique to the energy industry. One could argue, as I have heard our farmers argue, that over a long period of time we lose the productivity in the soil if we simply plant the same crop over and over again.

Were a farmer to do that, would you, based upon what you have suggested is the reason for your opposition to these tax benefits, would you then suggest that we apply a depletion allowance to farmers who have seen the productivity of their land reduced?

Mr. FIELDS. No, I would not.

Senator DASCHLE. So, there is some recognition of the uniqueness of various industries and the applicability of tax features to those industries.

Mr. FIELDS. Yes. Industries are different.

Senator DASCHLE. So, then, if that is the case, how can you put the stock you appear to in the need for some kind of broad applicability of tax features in agriculture to other areas as the condition upon which the administration would support them?

Mr. FIELDS. Because the conditions which generate the problem, that is satisfaction of debt with the bank and cancellation of indebtedness income, are not problems that are unique to the farming industry.

Yes, the farming industry is different, but the source of the fundamental problem they have is not unique.

As you know, Mr. Chairman, we have been faced with serious problems over the last decade with bankruptcies and declines of small businesses. People who were led to believe in the boom and invested their life savings in their business, whether it is a tailor, or a shirt maker, or a restauranteur, are in serious peril.

I see no reason why, when they go to the bank to renegotiate that they should be treated any differently than a farmer. Yes, the businesses are different, but the economic pressures on everyone have been extreme.

That is, by the way, also not our sole objection to the bill. But we believe that the bill is inequitable and we should consider, when we think about these things, other similarly situated groups.

Senator DASCHLE. Sarah, did you have a response to that?

Commissioner VOGEL. Again, I want to observe that the farmer and the farm business is intertwined. If a business takes a loss out there, the owner, unless he or she has directly pledged their home in support of the business loan, will not lose their home. Farmers—and there are thousands and thousands of them—lose it all.

When I was hearing the discussion about having the machine shop in the garage, I simply cannot conceive of a dairy farm or a cattle ranch, for example where the farmer is not close to the animals.

Senator DASCHLE. What you are saying is, in other businesses, generally a person could lose his business but not his home.

Commissioner VOGEL. That is right.

Senator DASCHLE. But home and business are all one unit in agriculture, so it does make agriculture unique in that regard. Does that not sound like a pretty logical defense of the uniqueness of agriculture for tax purposes, Mr. Fields?

Mr. FIELDS. If it were true.

Senator DASCHLE. It is true.

Mr. FIELDS. I do not have the statistics at my hands, and I do not know what the empirical evidence is. But we hear an awful lot from small businessmen who mortgage their homes, their only asset, to invest in their business.

And when that business goes south, they also have problems with their homes. That is a very common complaint, not unusual at all. So, I am not sure that the mere fact that the home is there makes the difference. Small business has had terrible problems.

It is not as if the administration is not sympathetic to these problems, but there are other sectors of the economy. If you think about the real estate industry, the exact same problems described by the other witnesses have devastated the real estate industry. Should we forgive all of their cancellation of indebtedness income and gain on sale? We have to grapple with those issues.

Senator DASCHLE. Let me turn to special use valuation, if I could, for a minute. There is a distinction between crop share agreements and cash leases. I had intended to ask you earlier, Mr. Fields, if you could differentiate between these.

Obviously, we all know that a crop share agreement is eligible for special tax treatment; more generous than a cash lease. Could you give us some basis for that distinction?

Mr. FIELDS. Yes. Again, the Code—and let me repeat——

Senator DASCHLE. Well, I know what the Code calls for.

Mr. FIELDS. Yes. It requires that a qualified heir make qualified use of the property. The legislative history describes qualified use as more than mere passive participation, that is, more than merely cash rental.

Those words are used in the legislative history in 1976. The courts and the Internal Revenue Service have accepted crop shares as having sufficient equity participation in the business to suggest that qualified use is going on.

Perhaps someone could have argued—and the Service has in certain cases when the participation gets tenuous—that that is not good enough, that is not enough participation.

But the theory is, if you are sharing in the profits of the business, that is qualified use. A cash rent does not share in the profits of the business.

Senator DASCHLE. What about that, Mr. McNulty? Is that a logical explanation as to why there ought to be a differentiation?

Mr. MCNULTY. The people that would be cash renting would still be at an economic risk. Just because you have a cash lease with somebody does not mean you are going to get paid.

So, they are still, as a family member, at economic risk for the operation of that farm. They are counting on the other qualified members of the family to make sure the farm shows a profit so they can allocate a portion of the profit on a cash method rather than on a crop share method. I think we can easily make the distinction that the cash lease in that scenario between family members would be a qualified use.

Senator DASCHLE. Mr. Dees.

Mr. DEES. The government equates the words "passive rental" in the 1976 legislative history with cash leases. That shows their lack of experience with the word in the long history of farming.

Since about 1958, the term "passive rental" has been used in the Social Security area to mean a lease without material participation by the owner. An active rental was one with material participation.

So, consistent with the government's test, it said if you did not materially participate, then your rental was not sufficient.

And if you went on in that same passage that he is referring to in the legislative history, the 1976 legislative history cited on page four of my statement, it says this is true if you have material participation, even though the party carrying on the business was not the decedent or a member of his family, so long as the decedent or member of his family materially participated in the business.

That exactly contradicted the IRS's original position. And, in 1981 when called before another subcommittee of the Senate Finance Committee the IRS did repudiate its position on qualified use and said that family member cash rentals were all right.

It went on on page five and six and actually had a Treasury decision that, even before Congress changed the law, wherein the Treasury said, "It has been determined that the equity interest requirement may be satisfied by either the decedent or a member of his family. Thus, a passive rental of a farm by a decedent to a member of decedent's family should not disqualify the property from special use valuation."

And they went on to say, "At a future date, the regulations will be reviewed to provide guidance where the parties involved include persons other than qualified heirs and members of the decedent's family." And, of course, that regulatory change has never been issued since 1981.

So, there is plenty of legislative history back contemporaneously to show that the 1976 statute did not have the qualified use test in it. The words in the statute are: "Used as a farm for farming purposes," and the IRS and Treasury has acknowledged this.

It was only after the legislative history to the 1981 act, and, sort of codifying their position—the IRS—it came out that and suggested that perhaps it was a limited relief and that they reverse

their position later, first, in non-family member cases, and recently in family member cases.

Senator DASCHLE. Well, that sounds like a pretty full explanation of the legislative history, Mr. Fields. Do you have any disagreement with that interpretation?

Mr. FIELDS. Yes. Mr. Chairman, I do not wish to get into a colloquy with Mr. Dees, but I believe that most of the facts he cited are not applicable to the qualified use standard and are distortive of the legislative history.

I really do not want to get into a debate on it, but I will point out several things. First, in his remarks, he referred to these rules as IRS-created and artificial.

The Code includes the requirement for qualified use. The legislative history says passive rental is not qualified use. The Service, if it arbitrarily imposed this test, would have lost in court.

But, in fact, on this issue where we are dealing with whether a cash rental is a qualified use, the Service has won in court, most recently as 1989 where the Tax Court, a very respected judge, Judge Featherson, on the court, said the Code is clear. Qualified use for this purpose is not a cash rental. That is not based on something the IRS made up, that is something that was in the original legislation.

What Mr. Dees is referring to a very complicated statute with a number of other provisions, some of which relate to the participation by the decedent prior to his death, some of which relate to material participation test of the heirs that is separate from the qualified use test.

There are a lot of tests here. His references all relate to those two situations—the decedent before death and material participation after death—not the qualified use test.

The Service has been uniform in its application there and the courts have supported it. We sit here today saying we agree the change should be made. But I think IRS bashing here is inappropriate.

Mr. DEES. I would call attention to the definition of qualified use so no one is misled as to what the definition is in the statute. It says, "use as a farm for farming purposes."

And that does not suggest that there is any at-risk requirement. I mean, if it is being farmed, I would submit that that language is plain on its face.

There are differences between the pre-death test and the post-death test for qualified use. There was not in the original statute as it was enacted in 1976. Those differences arose because of the 1981 legislation addressing specific cash rent issues rulings that were involved pre-death.

The hearings at the time looked at those rulings and said, this is ridiculous. The IRS and Treasury said, we agree, it is ridiculous. We are willing to reverse. And then Congress codified the result on a pre-death side.

Everyone at that time was saying that it was clear that this was not the intent. Yet, the codification of this agreement for the pre-death rule somehow closed the door on the post-death question. And that is what the judge and the Tax Court relied on.

The legislative history in 1981, which, unfortunately, suggested that they were opening the door for a few people and closing it cynically on everyone else, when I do not think that anyone thinks that that was the case.

Senator DASCHLE. Mr. Fields, I will give you the last shot here and then move on.

Mr. FIELDS. Yes. I will say, the notion that the 1981 legislative history somehow subtly opened the door to this—may I just quote from the legislative history? "The bill does not change the present law requirement that a qualified heir owning the real property after the decedent's death use it in the qualified use throughout the recapture period." This is not made up. That requirement has been there. If you go back to the original legislative history, a mere passive participation in 1976 would not have satisfied qualified use.

If I can just briefly quote—from the 1976 legislative history: "Your committee intends there must be trade or business use. The mere passive rental of property will not qualify." This language, coupled with the statutory language, is what made the courts comfortable with the strict position on cash leasing. They may not be happy with the result, but they are comfortable that that is what was intended.

Senator DASCHLE. Let me ask one final question with regard to special use valuation. In terms of eligibility, Mr. Dees and Mr. McNulty, you have heard Mr. Fields define and quantify what he believes to be the eligibility criteria for special use valuation. Are you satisfied with that interpretation of eligibility for family members? Mr. Dees or Mr. McNulty, either one.

Mr. MCNULTY. I did not understand the question, Mr. Chairman.

Senator DASCHLE. The question is, what legislation, if any, we should consider?

As I understand it, he thought that the term "family members" ought to include brothers and sisters. Are you satisfied with that general definition for cash leasing purposes?

Mr. MCNULTY. I believe Mr. Fields wanted the narrower definition applied. I would recommend the broader definition of family member.

Senator DASCHLE. Now, what is broader, in your interpretation?

Mr. MCNULTY. Anybody that would be defined as a qualified heir under 2032A, which essentially includes family members of a lineal descendent.

Senator DASCHLE. So, would you include it so far as to also add to the list spouses of brothers and sisters?

Mr. MCNULTY. Yes, I would.

Senator DASCHLE. You would. What about you, Mr. Fields?

Mr. FIELDS. Mr. Chairman, we would be supportive within the confines that anybody who could have been a qualified heir of the decedent may interlease, I guess.

Senator DASCHLE. Right.

Mr. FIELDS. However, that is not what S. 1061 does.

Senator DASCHLE. Oh, I understand.

Mr. FIELDS. All right. I just want to make sure that that is not S. 1061. But we would be willing to broaden that definition.

Senator DASCHLE. So, you would broaden it to brothers and sisters and spouses.

Mr. FIELDS. Oh, yes. Yes.

Mr. DEES. And would you have two tests, one under the material participation test, and one under the cash lease test that would be different people so that you had to cash lease to a narrower group of people?

Mr. FIELDS. I will answer this question directly. No bill under consideration is modifying the basic structure of 2032A. If there is going to be a proposal, I would have to see it specifically as to exactly where we are going. Moreover, I would spend a little more time on that specific issue.

Senator DASCHLE. For the record, it is probably asking a lot in each one of these cases, but I would like, for the record, if you could address that particular issue. Because, at some point, I want to design some legislation that addresses this whole area, and I want to do it as effectively as we can.

And I do not want to get into a debate about some of the technical questions related to eligibility, but I think it is a valid question that I would like to have some consideration of by the Treasury Department at least for the record.

Mr. FIELDS. Mr. Chairman, we believe that 2032A is very complicated, and agree that careful consideration of how to make it more effective and more understandable is completely reasonable.

I am not sure the problem that Mr. Dees describes, once we define the potential class of lessees in terms of the decedent's qualified heirs, is really that significant a problem. But I think that we should review the whole statute. In response to his specific question, I will submit a response to you. But I have to think more about it.

[The information follows:]

Hon. THOMAS A. DASCHLE,
U.S. Senate,
Washington, DC.

Dear Senator Daschle: This letter is to follow up on an issue raised during the April 29 hearing before the Subcommittee on Energy and Agricultural Taxation regarding special use valuation of farm property under section 2032A of the Internal Revenue Code.

At the hearing, I presented the Administration's views on S. 1061 and S. 1045, each of which would expand the ability of a decedent's heirs who inherit farm property to lease their interest in the farm on a net cash basis without disqualifying the property for the benefits of special use valuation. As I indicated at the hearing, we believe a qualified heir of the decedent should be able to net cash lease his or her interest to any other person who is a member of the decedent's family. Under that test, for example, a child of the decedent would be permitted to net cash lease to a sibling without jeopardizing the special use valuation.

A question was raised by one of the other witnesses whether, under the standard Treasury used to evaluate the two bills, the people to whom a qualified heir may cash lease would be a narrower group than the people who may satisfy the "material participation" test under the statute. You asked us to respond to the question for the record.

Under the Code, the qualified use test must be met by the qualified heir. It is clear that the ability to cash lease is related to whether the qualified heir is using the property in a "qualified use." Thus, the narrow exception in current law that allows a surviving spouse to net cash lease to a family member is stated in terms of the spouse not failing the "qualified use" test by reasons of the cash lease.

The "material participation" test is a separate test that must be met by the decedent or a member of his family, as well as the qualified heir or a member of the qualified heir's family. The material participation and qualified use tests apply to different groups and have different purposes. Both legislative proposals under consideration (as well as the test suggested in my testimony) would liberalize the

"qualified use" test under current law, but would not alter the separate "material participation" test.

Please let us know if we can provide you with any further information regarding this matter.

Sincerely,

JAMES E. FIELDS, *Acting Tax Legislative Counsel*

Senator DASCHLE. Mr. Dees, I would also invite you to do the same, if you could give us a more elaborate analysis of the complexities of that particular question, I would be appreciative.

Mr. DEES. The qualified use definition also creates some problems if it actually exists, in terms of the five out of eight year rule, and when it is applied on retired and disabled spouses.

There are lots of changes that were made by Congress with the idea that the qualified use test did not exist, and complexities occur if we start to acknowledge that it does exist and operate and that basis.

Senator DASCHLE. We have one more panel, but I want to clarify a couple of matters with Sarah Vogel and Mr. Greiner. Sarah, with regard to the number of cases, perhaps even in North Dakota, that you have witnessed relating to liquidation, to what degree, from your experience, in those cases where liquidation occurs do farmers have greater liabilities than they have assets?

Commissioner VOGEL. If I may, I think I would like to also have Dave Saxowsky respond to this question.

In 1989, North Dakota State University did a study and found that about half of the farmers who ceased farming had additional income tax liability because of their departure from farming. Of those, the average liability was $20,000. Again, the 33 negotiators and mediators that I work with have indicated that this is the number one problem of the farmers we work with.

It is also, I believe, the number one problem for lenders who would like to either work these financial problems out so the farmer can keep on farming, or assist the farmer in a graceful exit by means other than bankruptcy, foreclosure or any other harsh legal methodology. I believe Dave Saxowsky may have more to add.

Senator DASCHLE. Sure. Mr. Saxowsky.

Mr. SAXOWSKY. As part of that same study, we had an opportunity in our department to ask farmers, and, more importantly, former farmers about their financial situation as they left the industry.

The former farmers at that time—1987, 1989—were indicating that a third—not quite a third, but approximately a third—were looking at no equity in their farm businesses.

Now, whether that holds true in 1992, we have not had a chance to update our survey recently. But in 1987 and 1989 we were looking at approximately one-third.

Senator DASCHLE. Thank you. Mr. Greiner, you have addressed support for legislation that would extend the first-time farmer bond program for 18 months, but I assume you would support permanent extension.

Mr. GREINER. Yes. Absolutely.

Senator DASCHLE. You would.

Mr. GREINER. Yes.

Senator DASCHLE. Do you know why it is that some States have chosen not to avail themselves of the bond program?

Mr. GREINER. Well, I think there are several reasons. One of them is the extension. As I said, we have gone through four of them now.

And the uncertainty of it, a lot of States hesitate to start up a program with the problem that it may be closed down. California, however, is moving legislation through its General Assembly now, and hopefully they will have something up and running. There are many other States that are interested. As I said, South Dakota has expressed an interest; North Dakota has attended our meetings and expressed an interest in the program. They already have a beginning farmer program through their bank. There are States in the south that want to reactivate their programs.

One of the problems that happened was that in the 1986 Tax Reform Act, banks lost their deductibility on cost of funds. These bonds are not what we call bank qualified.

In other words, the bank cannot deduct its cost of funds. So, they felt that there was nothing in it for them, but there is. We have some banks that have 20–30 of these loans in their loan portfolio.

And I think the reason that many banks do this is they want to help an existing customer or get a new customer in the bank. They have used it some as a promotion. These bonds also qualify under the Community Reinvestment Act, and then they are tax-exempt. Of course, the interest income is tax-exempt.

But I think probably the overriding reason is the uncertainty. We in Iowa have gone along and just keep plugging away. Fortunately, we have done that, because we have been able to close a lot of loans. But some are very fearful to get into it for that reason.

If we had a permanent extension, you will see more States coming in. And we have had lenders tell us, your program is about the only thing available to beginning farmers right now that can help them. It is a lower interest rate, as Mr. McNulty said. It helps the cash flow, and the lenders are more anxious to do it.

In addition to lenders, we also do contract sales in Iowa where a farmer is wanting to quit and maybe does not have any children that are interested in taking over the farm. They will sell their farm on a contract to a qualified beginning farmer.

And those bonds, under Iowa law, are also State tax-exempt. So, that gets an even better rate for that beginning farmer. We have some going out at 6 or 6.5 percent under the contracts.

Senator DASCHLE. Well, I appreciate very much the testimony and the answers to the questions and the give and take that occurred with this panel. Mr. Fields, thank you for participating.

And, to all of you, thank you for traveling as far as you have. I know Mr. McNulty has a plane to catch and had to be out of the hearing room by 4:15. It is now 4:15, so let me excuse the entire panel. Thank you all very much.

Commissioner VOGEL. Thank you.

Mr. DEES. Thank you.

Mr. MCNULTY. Thank you.

Senator DASCHLE. Our final panel consists of Cheryl Cook, the assistant director for legislative services for the National Farmers Union; Jim Harris, of Union Grove, Wisconsin; and Ferdinand

Hoefner, the Washington representative, the Center for Rural Affairs; and Grace Ellen Rice, the associate director of national affairs for the American Farm Bureau.

If those people could come forth, we will take their testimony at this time. We are pleased you could be with us. Let me begin with the person to my left, Cheryl Cook, who is no stranger to agricultural issues, especially tax questions. Cheryl, please proceed.

STATEMENT OF CHERYL L. COOK, ASSISTANT DIRECTOR, LEGISLATIVE SERVICES, NATIONAL FARMERS UNION, WASHINGTON, DC

Ms. COOK. Thank you, Mr. Chairman. We appreciate the chance to be here today. Let me express my personal appreciation to you for letting Mr. Fields go home, because there is no way I want to debate him on 2032A. That almost single-handedly caused me to fail tax class in law school. [Laughter.]

I would also like to say that, as we address these issues and as we try to get our arms around the myriad of ways that the Internal Revenue Code affects farmers, we have got to keep everything in perspective.

And, as I know you know, income taxes are one thing, but you have got to earn the income in the first place. And the one thing that is going to attract new farmers into agriculture, that is going to keep old farmers selling their farms as farms and not as shopping centers, or condos, or something else, is the restoration of profitability to agriculture. That has to be the number one issue, and everything else, including the Tax Code, comes after that.

Particularly in times of recession when we are concerned about creating new wealth, agriculture takes a special role, I think. And, as one of our basic industries, agriculture creates wealth throughout the rest of the economy that affects not just farmers, but the tax and revenue spending side as well.

Within the bigger picture, I would encourage you in any tax bill that may come up before the end of the year to take another stab at breaking down the fire wall between defense spending and domestic spending, and really all program savings to other programs.

We found out last year in doing a dairy bill, for example, that savings in that program were not able to be used in offsetting the impact on the WIC program, and that kept us from doing some things that really should have been done for dairy farmers.

I would also like to talk about taxes in terms of international trade. Something else that we have heard quite a bit about in agriculture lately is the GATT negotiations, and also the North American Free Trade negotiations.

I would like to submit for the record, if I may, a copy of a study done by Oregon State University comparing sample wheat farms in Montana and Canada and Australia.

Senator DASCHLE. Without objection, that will be made part of the record.

[The study appears in the appendix.]

Ms. COOK. Thank you. This report comes to the conclusion that American farmers are at a disadvantage, compared to Australian farmers and Canadian farmers, questions of farm program and everything else aside, simply on the basis of the Tax Code.

There is a tremendous competitive disadvantage for American farmers, and that is something that has to be considered in any tax bill, and certainly any trade bill that may come along.

On the consumer side, again, getting back to farm income, I suppose we have to look at how the Tax Code affects demand for farm products and how farmers are able to sell their products.

In my home State of Pennsylvania, there is a considerable amount of unemployment. And many of my personal friends at this point who would love to be eating steak three nights a week, in fact, are eating corn flakes for two meals a day.

That has a direct impact, not just on farmers, but eventually on tax revenues, because the farm income comes down. Some of those same people also discovered barely two weeks ago today that they owed taxes on their unemployment benefits, and that, too, has had an impact on what they have been able to purchase, not just from the grocery store, but elsewhere in the economy as well.

My testimony consists of a laundry list of areas in the Tax Code that we think should be addressed, and many of them have already been touched on. So, in the interest of summarizing, I will move on to some of the other things that have not been touched on.

We talked a little bit about income averaging, but I would like to encourage you to consider some sort of legislation, again, recognizing that with fewer tax brackets, there is only so much we can do with income averaging.

We would recommend some kind of carry forward of unused personal exemptions at least for 3 years.

We are in favor of expanding the investment tax credit, but we would prefer to target its use to investments in American-made products if any way possible. Farmers are not the only ones who have not been able to replace worn out equipment, but certainly they provide a good example.

If a farmer can go out and buy a new tractor and that tractor was made of American steel, and running on American tires, and he is looking out at his crop through his American window, then certainly the entire economy will benefit, and the taxes, as well.

The deductibility of health insurance premiums is something that has been a major issue within the National Farmers Union. It has been time and time again a special order of business from our annual conventions, and this year was no exception.

We would recommend full deductibility of health insurance premiums, and that that be made a permanent part of the Internal Revenue Code.

We are in support of an idea that has been proposed by the President a couple of times, and that is the transfer tax on traded stocks and commodity futures.

We think this is a new source of revenue that could be used in any number of ways, most especially for us in funding some kind of a crop insurance program.

The speculators on the Commodity Futures Boards are those who come up with the greatest benefit when there is a natural disaster, and we think they ought to be contributing toward those who take the greatest hit where there is a natural disaster. And if you have got any farmers in your State getting their disaster checks, you know what I am talking about.

We would encourage you to have a separate hearing, even. Actually, all of these issues deserve their own hearing, but particularly on the case of *Arkansas Best Corporation* v. *the Commissioner of IRS,* a decision which is being interpreted as allowing only capital treatment of hedging.

We think there is a difference between hedgers, such as farmers, and speculators, and there ought to be ordinary income consideration for those who are hedging what happens to them in the cash market.

Let me skip over to the end and talk for a moment about the tax consequences of debt restructuring. This is an issue we have been working on for a long time, as you know.

And the American Agriculture Movement and the National Family Farm Coalition have both asked me to indicate their support for pressing forward on this issue. I will end there. Thank you very much.

[The prepared statement of Ms. Cook appears in the appendix.]

Senator DASCHLE. Thank you very much for your very fine testimony. Mr. Harris.

STATEMENT OF JAMES HARRIS, UNION GROVE, WI

Mr. HARRIS. First of all, I would like to thank you, Senator, for this opportunity to testify on behalf of the American farmers.

We strongly endorse Senator Kasten's bill, S. 1130, entitled Family Farm Tax Relief and Saving Act of 1991, and other similar bills that have been sent up by the members of Congress.

I recall you asked, Senator, was there any caps. I do not know the definition of caps, but there certainly are some limits that are written into the bills.

For brevity, the bill may be referred to as FRA, which stands for Farmers Retirement Account, in this presentation.

FRA re-establishes the farm assets as the Farmer's Retirement Fund, correcting the hardships caused by the capital gains tax revision of 1986 and the oversight or failure of Congress to recognize that the farm investment unit does satisfy the intent and criteria for investment of funds required with the IRA concept.

The bill is unique in that it neither advantages nor disadvantages any farm region, product, or activity. It will provide great incentive for substantial long-term investment commitment to rural America, also to the farm unit, because a farmer can, without reservation, devote all assets to the farm development, keeping his retirement funds at home on the farm, not Texas S&Ls or South African gold mines.

The bill recognizes the need of the special farming situations—tennant and custom farming—which holds little or no real estate, but has huge investments in crops, animals, and machinery.

What I am saying here is, do not stand behind the proposed $125,000 farm homestead exemption as the total answer, because there are too many farmers that do not hold real estate property, but do urgently need old age survival funds.

Our goal is to treat a portion of the family farm assets as a self-directed IRA, with income tax deferral, rollover, and make-up privileges comparable to those granted other taxpayer's self-directed IRAs.

Farming is an extremely capital-intensive profession and occupation. Long-term growth and success of a family farm requires all of the farmer's capital resources. One dollar of the farmer income yields ten cents to the kitchen, 90 cents to the bank to borrow $10 more, and that is on a good day.

White and blue-collar workers and other professionals make large incomes that require little capital outlay. These people are allowed generous tax preferential treatment of large sums invested in retirement packages, the IRAs, the KEOUGHs, 401ks, deferred compensation, S.S. doubled by employers contribution, and so forth, and employer-paid retirement funds and paid—non-taxed—insurance packages.

These funds are invested in commerce. Let the farm be the commerce for the farmer's IRA. The farm investment certainly satisfies the intent and purpose of an IRA, and is much more valuable to Rural America then Boelsky's Junk Bonds and California and Texas S&L's which qualify for IRAs.

Throughout history, the farmer's capital appreciation was a farmer's retirement fund and was given tax preferential treatment by means of the previous long-term capital gains tax exemption.

Capital gains accumulated by a family's hard labor on the farm certainly deserves more consideration than passive stock market poker money.

Genetics of a farmer's dairy herd is family developed from grandparent to grandchild, and the farmer is an active, not a passive, risk participator. Plus, he is the major investor and tax supporter of the rural infrastructure.

When retiring, all proceeds are taxed at a high tax rate, as if one's lifetime blood and sweat assets were earned that year; no consideration for the devastating taxes on inflationary gain.

Paper stock gains are easily held and averaged for retirement years; agricultural assets, impossible. When net farm income is limited or non-existent due to the combination of persistent low prices and required capital expenditures, by law, no tax-exempt IRAs and only limited Social Security can be funded.

As a result, IRAs are unaccessible for many farmers. Let me also add that, unfortunately, many farmers chose not to pay the alternative minimum Social Security tax, not realizing that if they do not pay any Social Security tax in five of the last ten years, they are not covered by disability insurance. A farmer is regarded as vital society. The farmer's capital is invested locally, and so forth. I will move on.

The typical annual retirement package available to a $12–$14-an-hour Wisconsin State employee—and basically I am talking about my wife's package as a State employee of the State of Wisconsin as a clerk-typist—the employer paid retirement is worth around $3,000 a year.

Employer paid Social Security, 7.65 versus 15.3 is worth another $2,300. On top of that, she is allowed to go to $7,500 shared or self-paid 401k, with a $22,500 hardship make-up privilege in three of the last 4 years of employment.

She has an annual $2,000 self-paid IRA, we have a total there of $14,800. On top of that, she has employer-paid non-taxed health

insurance—a $5,000 a year package. An equal spousal IRA account would be available if I worked there.

Let me say this. The $10,000 farm F-RA bill cost considerably less than one-half of the typical IRA package—refer to attached graphs to amended testimony. I could go on and on on the unfairness of this issue. If one must, take some away from the over-endowed, let us do it, and give it to the ones that are under-endowed.

I see the light is on, so I would like to call attention to the graphs that are in my testimony. What I have here is a computer print-out of a hypothetical $1,000 a year contribution to an IRA —one-half of the allowed $2,000.00 annual IRA. The account pays 8 percent per annum, compounded monthly, deposited at a rate of $83—that is $1,000.00/12 months—a month. In 46 years, that $83 a month achieves the $500,000 that we are asking for in this package—$63.80 monthly achieves $500,000 in 50 years or total cash input of $38,300.

Now, if we go to some of the more liberal ones that we have, my brother is one I could talk about. He is entitled to roughly $20,000 annually in retirement account deposits. He achieves $500,000 in about 14 years. Within 50 years, an account of $13 million plus.

Now, I said the $1,000 per annum—one-half of a $2,000 IRA—at 50 years has a value of $652,000, if we pro-rate that down, then $766 deposited annually at $63.80 per month rate achieves $500,000 at 50 years.

Now, that is much less than a quarter of a working couple's combined $4,000 IRA. A couple could have two $2,000 ones, so that is $4,000. A working farm couple's $500,000 F-RA costs $766.00 per year, that is only 19 percent of the minimal $4000.00 IRA. I do not think we are asking too much, and more we should get.

Senator DASCHLE. That is a very helpful chart. You say that is part of your statement, Mr. Harris?

Mr. HARRIS. I modified it a bit here to talk from, but I could remake it and send it to you.

Senator DASCHLE. Could you do that?

Mr. HARRIS. I certainly could.

Senator DASCHLE. I would like to put that in the record as well, if I could.

[The chart appears in the appendix.]

Senator DASCHLE. Mr. Hoefner.

STATEMENT OF FERDINAND HOEFNER, WASHINGTON REPRESENTATIVE, CENTER FOR RURAL AFFAIRS, WASHINGTON, DC

Mr. HOEFNER. Thank you. And thank you for this opportunity to testify. I have submitted a written statement and will just summarize. I state at the outset that the Center for Rural Affairs, as you well know, has been outspoken in opposition to special farm tax breaks that stimulate investment in agriculture.

The result of most tax incentives in farming has been declining profitability, increased volatility in the land market, farm consolidation, and competitive disadvantage for smaller and beginning farmers—in sum, tax policy-inspired decline of the family farm system.

The capital gains exemption is particularly troublesome. It turns breeding and dairy livestock into a tax shelter and it turns appreciating land values into a tax shelter. That, again, puts moderate-sized, moderate-income farmers at a competitive disadvantage as supplies expand and prices drop.

So, we have historically been very wary of any special tax breaks in farming. But, despite that caution to start with, we nonetheless believe that there is a role for some carefully targeted tax relief measures to enhance opportunities for beginning farmers and to remove tax obstacles to farm debt relief.

American agriculture is certainly in need of a new generation of family farmers and a new source of affordable and accessible capital for those farmers.

And we stand at a crossroads where half the nation's farmers are going to retire within the decade, and yet, new farm entry rates are dropping very severely.

So, we have a public policy choice to make, I believe, as to whether we are going to allow the permanent loss of rural people and rural economic opportunities, or whether we are going to revitalize and restructure agriculture for a new generation.

We strongly support the Beginning Farmer and Rancher Credit Act, which is a subject of hearings in the other body today and tomorrow. And, at the same time that that bill would restructure and revitalize Farmer's Home, we believe that there are things that this committee could do to complement that effort.

The first one, which has been addressed by many people today, is the Aggie bond program. Just to summarize, we believe that the tax exemption should be extended, and preferably on a permanent basis.

But, also, we would point out that Congress should override an OMB directive that prohibits Farmer's Home from guaranteeing Aggie Bonds. If that was overturned, it would greatly expand the market and help beginning farmers.

That is a change that is included in the Beginning Farmer and Rancher Credit Act, and that bill has been endorsed by Farmer's Home and USDA.

The third thing we would raise is not a tax issue, per se, but if community-based non-profit rural development corporations could be allowed to service Farmer's Home guarantees, that would also extend the Aggie Bond program further to reach more beginning farmers.

Our second recommendation deals with capital gains relief for retiring farmers. We would oppose the bills under consideration that offer capital gains relief, unless they were targeted to land owners who were selling to qualified first-time farmers.

We need to carefully target both the buyer and the seller end of these transactions if we are going to achieve a public policy goal of supporting a new generation in agriculture.

So, we would strongly advise that if those bills are considered further, that targeting on who is buying the land be included so that they are targeted to beginning farmers.

We would point out that it would be fairly easy to do that kind of targeting. There is already the first-time farmer provision in the

Aggie Bond program, and there are also Farmer's Home definitions that could be applied in the Tax Code.

A final set of recommendations on beginning farmers deals with IRAs. This committee has discussed in the past possible penalty-free withdrawals from IRAs for various purposes, and we would just like to throw into that hopper the idea of first-time farmers being able to withdraw money from IRAs without penalty for the first-time purchase of land and other assets.

If we did that, we would invent a savings and equity investment approach to entering agriculture to complement, and maybe in part to replace, the debt financing approach which is more familiar. This would, at the same time, begin to counteract the bias within IRA policy against self-employment.

And, finally, turning to the tax on farm failures, we continue to urge this committee to pass S. 900, the Farm Debt Tax Reform Act.

This bill contains carefully crafted exclusions for capital gain and debt discharge income upon the transfer of farm assets to satisfy debt obligations.

And it includes strict income equity and material participation tests, a joint lifetime cap, and a write-down of tax attributes. I consider that a fairly significant amount of targeting.

I would just like to comment briefly on the administration's testimony and suggest that we need a revised Joint Tax Committee revenue estimate on this as soon as possible because their previous one certainly conflicts with what you heard about today by a significant amount of money.

I would also point out that the revenue estimates that we heard about today seem to be in conflict. If we have an $800 million 5-year estimate on a broad-based capital gain exemption for retiring farmers that is untargeted, how can it be that the far more targeted provision for farmers who are in a situation where they do not have an ability to pay cost more? I know there is retroactivity involved in it, but it just does not seem to make sense to me.

And, finally, asking a rhetorical question, how can the administration argue unlocking of capital gains with a great boost in revenue on general capital gain exclusions, and then say for these limited number of people with no ability to pay that to unlock their assets so they can get on with their life, maybe get a new job to start owing taxes again, and to unlock those assets so that somebody else is using them productively and paying taxes, but that costs $1 billion? It does not make sense.

Senator DASCHLE. Mr. Hoefner, I wish I would have thought of asking that question. That is an excellent question. They were using it all year long as a revenue-generating measure. Now, when it comes to applying it directly to agriculture, they see it as a deficit-creating measure, which is hard to reconcile.

Mr. HOEFNER. That is right.

Senator DASCHLE. Thank you for your very excellent testimony.

Mr. HOEFNER. Thank you.

[The prepared statement of Mr. Hoefner appears in the appendix.]

Senator DASCHLE. Ms. Rice.

STATEMENT OF GRACE ELLEN RICE, ASSOCIATE DIRECTOR OF NATIONAL AFFAIRS, AMERICAN FARM BUREAU, WASHINGTON, DC

Ms. Rice. Thank you, Mr. Chairman. My name is Grace Ellen Rice, and I am Associate Director of the Washington office of the American Farm Bureau. I will summarize my statement for you this afternoon.

First of all, we would say that the tax decisions of the Senate Finance Committee affect our membership as much as the decisions of the agriculture committees. We are pleased that the subcommittee is holding a hearing on several bills important to farmers and ranchers.

Our policy in Farm Bureau is adopted by our producer members at the county, State, and national levels. And there are several positions which are important and speak to the bills before the subcommittee today.

These positions are: we urge Congress to permanently extend the authority for Aggie Bonds, which are used by States to finance loans to beginning farmers.

We support a capital gains exclusion for insolvent farmers on liquidation of farm property.

We support a capital gains exclusion for landowners who were forced to sell by condemnation and who do not wish to purchase new land to continue agricultural operations.

We support continuation of the once-in-a-lifetime exclusion of up to $125,000 in capital gains on the sale of a primary residence for taxpayers over age 55, and changes in the law which would permit portions of the resident farm other than the immediate farm residence to be eligible for this exclusion.

We support a provision to allow a farmer, other business owner, or self-employed taxpayer in contemplation of retirement, to invest proceeds from the sale of property and machinery in an IRA, KEOGH, or similar retirement account.

In addition, our policy calls for the repeal of Federal estate taxes. And until that repeal is accomplished, we oppose any reduction in the current Federal estate tax exemption, or, to continue, we support the elimination of the $750,000 ceiling on special use valuation.

While we have not had an extensive amount of time to analyze the technical implications of the bills before the committee, our policy does address several of these specifically: S. 710, First-Time Farmer Bonds, S. 900, Capital Gains Relief on Transfer of Property to Satisfy Indebtedness; S. 1130, which is the Farmer IRA; and S. 2202, Exclusion of Gain on the Sale of Farmland. We support these bills, based upon our policy.

With regard to the other bills, while we do not have specific policy on S. 887, or S. 1045, or S. 1061, we support any legislation which lessens the estate tax burden on the transfer of property from one generation to the next. With that position in mind, we would also support those bills.

There are two additional points. We encourage the subcommittee to continue to look at the importance of capital gains treatment to agriculture because of the effects that it has on owners of timber, or farmland, or livestock.

And, we urge 100 percent and permanent deductibility of the health insurance tax deduction for the self-employed, which we know that you and others on the subcommittee have been very active on. We certainly look forward to that day when the deduction is permanent and when it is for the total amount of premium. With that, I conclude. Thank you for your attention.

Senator DASCHLE. Thank you very much, Ms. Rice.

[The prepared statement of Ms. Rice appears in the appendix.]

Senator DASCHLE. Could you give me any indication as to how the Farm Bureau might prioritize each of these bills in terms of their helpfulness to family farmers? Do you have a sense as to which might be the most important?

Ms. RICE. I can tell you the ones that we hear from our members most, and I think that would be a good indication. The $125,000 capital gains exclusion extending to a farmstead, and the Individual Retirement Account for farmers that was mentioned previously. And I suspect that those two would be the most important ones.

We also have members in certain States where Aggie Bonds are sold who are very supportive of the Aggie Bond exemption. So, I would say really those three.

Senator DASCHLE. Mr. Hoefner, I sympathize somewhat with your comments—more than somewhat, substantially with your comments about the need to carefully create tax treatment, especially relating to capital gains so as not to create shelters that have somewhat of a negative effect, a substantial negative effect, in some cases, as we have seen in the past.

Could you give the subcommittee guidelines by which one differentiates between effective tax treatment and sheltered income related to agriculture?

Mr. HOEFNER. I think we could. I would just suggest, in terms of the two capital gains bills, that if the break is going to go, but the land is going to be sold to investors or to well-established farmers with significant farm assets, that we have not achieved a valid public policy objective to justify spending that amount of money, whatever the revenue estimate is.

Where we come down is that if it is a real active farmer, materially participating, selling to the next generation, using any one of several definitions of first-time farmers—and I think we could put one together that would probably satisfy everybody—that then you have created a situation where there is a much larger public policy purpose to be served. And that is the kind of thing that we would support.

Senator DASCHLE. Well, you say first-time farm buyers. Let me just take one example that we talked about this afternoon in discussing special use valuation and cash leasing.

What if you had a second generation operation in the area, contiguous to a farm where the father has chosen, now, to sell.

He wants to sell to his son who is already farming, or, you could even argue, in this case would inherit the land should the father pass away. Under an arrangement like that, would you say that cash leasing for tax purposes ought to be treated as we have discussed in the legislation this afternoon?

Mr. HOEFNER. I think so. I think if the son was probably renting most of the ground or had some small ownership stake but not a

very large one, I would think they would meet most first-time farmer tests and that that would be legitimate.

Senator DASCHLE. Generational transfers ought to be encouraged to the extent we can. But you would tie them as much as possible to access to first-time operators.

Mr. HOEFNER. Yes. That is right.

Senator DASCHLE. What about associated family members?

Mr. HOEFNER. I do not think you need to make too much of a distinction of who the person is, as long as they would meet the first-time farmer test. Whether they were heirs or completely outside the family would not make that much of a difference.

Senator DASCHLE. Right. But I guess my question was, what about family members who are currently farming. Let us say, spouses of sons or daughters. Do you have any problem with that?

Mr. HOEFNER. No.

Senator DASCHLE. All right. What about the question or the objection raised by Mr. Fields fairly consistently which was, look, there is nothing unique to agriculture tax-wise. I can put a small businessman into the same set of criteria, and they ought to be eligible for the same treatment that farmers are eligible for.

So, you really cannot define a situation unique to agriculture that would then qualify them for unique tax treatment. Is that a fair statement? And, if not, how would you rebut it, anybody?

Mr. HARRIS. I will take that.

Senator DASCHLE. Mr. Hoefner, go ahead. And then Mr. Harris.

Mr. HOEFNER. I would just throw in this slightly different tack, which is to remember that this whole tax discussion on farm debt relief came as a result of the 1987 Ag Credit Act.

And that act, in terms of the revenue side, was premised on the fact that the government was going to save money by writing down rather than foreclosing. Then, suddenly, everybody realized that this was not going to work for many people because of the tax liability.

So, whether or not farmers are unique overall, this has a legislative history that is not unique to the tax side. And if the promise of the 1987 Credit Act is going to be fulfilled, the tax question has to be resolved. And, obviously, if you are going to resolve it beyond farmers, you are going to get into a lot more revenue.

Senator DASCHLE. Mr. Harris.

Mr. HARRIS. The comment that I would make in that line is that a year or two back, General Motors published a statement to the effect that they had $29,000 worth of capital investment per employee. You go out to the farm, it is not hard to find $1 million of capital investment per employee.

You go into the other small business that may be going through bankruptcy, the restaurant chain changes inventory roughly every 4 days, the hardware store changes its inventory every 3 months. Our inventory of our tractor and combines may change once every 20 years. Add to expand my cow and calf operation.

We get into the real estate tax business and in our county, before I go out to the field, I have $40 per acre of real estate taxes to pay for, which certainly is going to support a lot of other homes than the one that is on the farm.

Besides that, if we are looking at $2,000 an acre land and 10 percent money, we get $240 to cover taxes and interest before we head to the field. A lot of our crops today do not raise $240 worth of crops per acre. We, too, have gone through 3 of the last 4 years which have been very bad.

I would like to also comment that this FRA, many people tell me, this would be very much of advantage to them as an incentive for the son to take over the farm, because it gets dad out of the operation clean and free without long-distance, tied up sales that bring in lots of tax consequences and incurring tie-ups and lawyer fees.

That if they could just walk away from it and say, this is yours, son, I have got my retirement account. I do not have to go through all the Mickey Mouse of getting the attorneys rich in working out a method to hand the farm operation over.

We can do this with a nice little basic simple FRA law that says: You must farm 5 years to be a full-time farmer to qualify. Then you can count the years that your wife was a full-time helpmate, or the spouse was a full-time helpmate, up to a maximum of 50 years per farm unit.

Now, it may be a bachelor for 50 years, or a spinster for 50 years, or a married couple for 25, or any combination. The next thing is, you multiply the total years by $10,000, and you have to have qualified farm assets to sell to get the money into it. It is a very simple law. Nobody needs to enrich a lawyer's pockets by utilizing it.

Senator DASCHLE. Thank you, Mr. Harris. Ms. Cook.

Ms. COOK. If I could jump in quickly here. I do not know how I would top that, Mr. Harris. But there are a couple of areas where I would disagree with Mr. Fields. And you have got to take each of these tax issues almost on a case-by-case basis, I suppose.

I strenuously disagree on the debt restructuring question, whether agriculture is the same as other small business. I do not think it is. I think agriculture is unique, for a number of the reasons that have already been articulated, particularly by Sarah Vogel.

But even in cases where they are the same, for example, the deductibility of the health insurance premium, is the answer that you do not give it to anybody, or is the answer that you encourage small businesses by giving it to everyone?

My preference would be the latter. I think we would take a much more holistic view of how do we get this entire economy moving again to everybody's benefit, than I think Mr. Fields seemed to be taking.

Senator DASCHLE. Good point. Well, I have no further questions. I appreciate very much this panel waiting as long as they did to present their testimony. I think it has been a very productive afternoon. You have enlightened us substantially.

This is an area that I think will continue to receive additional consideration and attention. We would like the opportunity from time to time to consult you with regard to these changes as we get closer to the time that we will markup legislation relating to taxes and agriculture. But we made a good start today, and we thank you all very much. The hearing stands adjourned.

[Whereupon, the hearing was concluded at 4:51 p.m.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR KENT CONRAD

Mr. Chairman and members of the Committee, thank you for the opportunity to testify this afternoon. I commend you for addressing these important taxation issues that affect farmers.

I am here to address a topic of central importance to rural America—survival of the family farm. I have sponsored two bills to help families hold on to their farms in times of economic distress or death in the family, and to relieve some of the enormous tax burden that can occur when a farm is lost.

Before I begin, I would like to thank two witnesses who have traveled from North Dakota to be with us today. Allow me to introduce Sarah Vogel, North Dakota's distinguished Commissioner of Agriculture, and David Saxowsky, a highly regarded professor of economics at North Dakota State University. Thank you both for sharing your expertise with this committee.

Mr. Chairman, net farm income was lower in the 1980's in real dollars (after adjusting for inflation) than in any decade since the record keeping began in 1910—including the worst 10 years of the Great Depression. That led to a crash in the value of the assets of the agricultural community—net assets dropped from $1.1 trillion in 1981 to $600 billion by 1987.

Despite attempts to counter the current crisis in family farming, thousands of farmers will fail if the current tax treatment of debt restructuring arrangements is left unchanged. For others who have lost their farms, huge tax bills will hang over their heads for years to come, clouding what prospects they had for making a modest living. Other families find themselves stuck with big estate tax bills because of a technicality in the tax code, which Congress partially addressed in the 1988 tax bill.

S. 900: CAPITAL GAINS RELIEF FOR FARMERS IN DEBT

Farmers engaged in debt restructuring can encounter either—or both—of the following tax problems. When property is deeded back to a lender in exchange for debt relief, the farmer will realize a capital gain if the fair market value of the property is above the basis (purchase price plus improvements). It is the same tax the farmer would owe if he or she sold the land, only in this case there is no cash from the sale. The farmer could also owe some tax on debt relief received from a lender, unless he or she is insolvent or has unused tax attributes to apply as offsets.

Let me provide a numerical example. Suppose a farmer had a loan for $250,000 and conveyed back land worth $150,000 to eliminate this debt. Assume this land had a cost-basis of $50,000. Under current law, this farmer would have to pay tax on a capital gain of $100,000. Though such gains are illusory, they will be taxed as ordinary income.

The farmer in this example would also realize $100,000 of discharge of indebtedness income. To offset this income, he or she can draw on any tax attributes, such as unused investment tax credits and net operating loss carryovers, and can reduce basis in other property. After taking these steps, there will still be a tax on discharge of indebtedness income, unless the farmer is insolvent.

My bill, which has been cosponsored by several of the distinguished members of this committee, addresses both of these tax problems for farmers who are technically solvent but clearly lack the ability to pay. It would provide a limited, once-in-a-lifetime exclusion for farmers with low to moderate incomes and few other assets, to relieve them of the tax owed on discharge of indebtedness income or capital gains that arise from debt restructuring.

The exclusion is clearly targeted: large farmers, wealthy investors and speculators, and others with significant assets will not be helped. To qualify for the exclusion, farmers would need to meet the following three tests: (1) at least 50 percent of gross receipts in 6 of the last 10 years must be attributable to farming; (2) modified adjusted gross income is less than 100 percent of the national median adjusted gross income; and (3) equity in all other property is less than $25,000 or 150 percent of tax liability, whichever is greater. The exclusion is limited to $300,000, the same limit on the size of the write-down that exists under the Agricultural Credit Act.

This bill is similar to measures I introduced in 1988 and again in 1989. In July of 1989, the Senate Finance Committee held a hearing on the legislation, which demonstrated the need for such tax changes and suggested a number of technical revisions that have now been incorporated. During action of the fiscal 1990 budget reconciliation bill, the Committee adopted key provisions of my bill which extended relief from the taxes on discharge of indebtedness income. Subsequently, however, this legislation was deleted from the reconciliation bill on the Senate floor in a leadership move to scale back and expedite passage of the omnibus budget measure.

Since the Agricultural Credit Act of 1987, over 12,000 borrowers from the Farmers Home Administration have received some form of debt forgiveness as part of their debt restructuring. As we continue to deal with the aftermath of the farm crisis of the 1980's, more farmers will receive debt restructuring. Enacting this legislation will help thousands of family farmers whose attempts to restructure their debts have led to huge tax bills which they clearly cannot pay, and will save thousands more from such personal tragedy in the future. I strongly urge the committee to support this legislation.

Mr. Chairman, I am awaiting a revenue estimate on this bill from the Joint Tax Committee. I would like to note, however, that in real terms the amount of tax revenue forgone would be minimal because it is unlikely that many of these farmers will ever be able to pay such enormous tax bills.

I would also like to address another section of the tax code which affects family farmers.

S. 1061: A TECHNICAL CORRECTION ON SPECIAL USE VALUATION

In 1988, the technical corrections act made an important change in the estate tax law that will enable more farm families to keep an ongoing farming operation in the family when the property owner dies.

Section 2032A, as amended by the technical correction, extends special use valuation of farm property to surviving spouses who continue to cash-rent farm property within their families. Without this change, a recapture tax would have been imposed in such situations. By allowing the spouse to qualify for special use valuation, the correction was clearly intended to allow a farmer to transmit farm land to his or her children who would then continue to farm the property.

The 1988 provision, which applies to cash rentals occurring after December 31, 1986, was clearly helpful, but it did not entirely solve the problem. If there is no surviving spouse, it is not possible under the 1988 law to transmit such property to one's children or grandchildren without triggering the recapture tax.

My bill would apply to such analogous cases. For example, a North Dakota farmer cash-rented farm property from his mother, who had received the property from her father. Neither the daughter nor the grandson qualifies for special use valuation because the provision applies only to surviving spouses.

I do not believe such situations are widespread, and it seems likely that Congress did not anticipate them when the language on surviving spouse was approved in 1988. But these cases do exist, and I believe they deserve the same treatment under section 2032A.

In the House, Congressman Dorgan has introduced companion legislation. In addition, this bill is quite similar to legislation introduced by my distinguished colleague from Kansas, Senator Kassebaum, which I have cosponsored. My bill would apply to qualified heirs (including ancestors, spouses, and lineal descendants and their spouses) who are immediate members of the decedent's family, while Senator Kassebaum's bill applies to lineal descendants only.

Although legislation covering lineal descendants would solve the problem faced by the constituent I referred to above, broader language may well save us from future technical corrections covering unforeseen family circumstances.

While I have not yet received a revenue estimate from the Joint Tax Committee, I expect minimal loss because of the very low-numbers of people affected by this.

Mr. Chairman and Members of the Committee, I thank you for the opportunity to address the unfair tax burden faced by some of our nation's family farmers, and for your attention to these important matters.

ADDITIONAL VIEWS OF SENATOR CONRAD IN RESPONSE TO TREASURY DEPARTMENT COMMENTS

I would like to address some of the erroneous concerns raised by the Treasury Department over S. 900, the Farm Debt Tax Relief Act.

(1) The Administration believes this legislation would result in "substantial revenue loss." An honest and realistic look at the tax situation of farmers and former farmers affected by this bill reveals that there is little likelihood that the federal government will ever be able to collect these taxes. Remember that these farmers are being taxed on phantom capital gains assessed when land is deeded back to a lender or on debt forgiveness received from the lender.

Many of these farmers lost their land and everything else. Others are, at best, merely less in debt than they used to be. They are not making a great deal of money and there is no cash to pay these unfair tax bills. Furthermore, the bill incorporates strict targeting criteria, including net income an equity tests, to ensure that only those without ability to pay benefit from the relief. The primary effect of these tax liabilities is to frustrate farmers as they attempt to start new lives or leave older farmers destitute and facing an impoverished old age.

While the Joint Tax Committee has not yet produced a revenue estimate on S. 900, in 1990 it estimated revenue loss of $352 million over five years on identical legislation which I introduced last Congress. This is considerably lower than the Treasury Department's estimate, although both estimates fail to take into account that most of these taxes will never be paid.

(2) The Administration objects to the proposal because it specifically targets farmers, arguing that farmers should be treated no different than any other troubled family business. There is, however, clear evidence that the family farmer is indeed different from other family businesses.

No other business sector is subject to such dramatic fluctuations in prices and property values. Nor is any other business so completely land-based. We have only to look at the past two decades for evidence. The huge increase in farm values of the 1970's as export markets boomed was then followed by a staggering decline in the 1980's, when exports plummeted and the real value of net assets dropped from $1.1 trillion in 1981 to $600 billion by 1987.

Moreover, farmers are uniquely and routinely subject to weather conditions which can cripple their businesses. The drought of the last decade is surely proof of that.

(3) The Administration argues that this legislation is unfairly targeted to solvent farmers and does not require that a farmer be unable to pay the taxes or in financial difficulty.

As the Administration notes, insolvent farmers are protected under current law from being taxed on discharge of indebtedness income. This legislation is designed to help those farmers who are technically solvent, but clearly do not have the ability to pay. For these farmers, payment of the tax (to the extent they could muster the funds) would push them into insolvency or bankruptcy, ironically putting them in the relief area where they would be protected from the tax.

As for the Administration's argument that the bill does not require farmers to be in financial difficulty—would you deed back your land to the lender if you weren't in financial difficulty?

Moreover, this legislation is targeted to farmers who meet the following tests: (1) at least 50 percent of gross receipts in 6 of the last 10 years must be attributable to farming; (2) modified adjusted gross income is less than 100 percent of the national median adjusted gross income; and (3) equity in all other property is less than $25,000 or 150 percent of tax liability, whichever is greater; and (4) material participation.

(4) The Administration argues that this legislation would distort the market for farm property, creating an artificial tax incentive for transferring farm property to a lender in satisfaction of a debt, even if the property has fair value significantly in excess of the indebtedness.

Frankly, would you deed back your land if you could make a lot of money selling it on the open market? Why give back property that is far more valuable than the debt carried on it?

(5) The Administration objects that the legislation would be too complex to administer. Clearly, as I have mentioned above, this legislation has specific eligibility criteria to insure that only those farmers truly in need would receive tax relief (another concern of the Administration). These criteria were developed in response to comments that a simple test could not sufficiently target the farmers in need of help

while excluding those with the ability to pay. While specific, none of these criteria are overly burdensome.

To summarize, while I appreciate the attention which the Administration has devoted to studying this proposal, I believe that its conclusions are unsubstantiated. I hope that the information which I have provided above will lead to a reexamination of the Administration's opinion.

PREPARED STATEMENT OF CHERYL L. COOK

Thank you, Mr. Chairman. I am here today—exactly two weeks after doing my part for the Internal Revenue Service—on behalf of the 250,000 farming and ranching families of the National Farmers Union, and we appreciate this opportunity to comment on tax issues facing farmers. The ideas in my statement have been gleaned from our 1992 policy program, and represent part of our larger economic recovery proposal, which is attached.

Let me begin by stressing that questions of income taxes, as complicated and burdensome as they may be, are secondary to questions of earning the income in the first place. In the mid-1980's, history repeated itself when agriculture led the way into the recession now being felt by the rest of the economy. I cannot stress enough the importance of restoring profitability in agriculture—not just for farmers, but for the rest of the economy and even for the government's tax receipts.

One purpose of taxation is to redistribute wealth, and the creation of new wealth is essential both to a socially-just wealth distribution system and to any long-term economic recovery. We will never prosper as a nation by frying each other's hamburgers for minimum wage!

As the most basic of industries, agriculture serves as one of the United States' best sources of renewable wealth. The wealth created with each year's crop multiplies countless times throughout our economy, as raw commodities are transported, processed, prepared, and sold to consumers here and abroad. In 1986, roughly 21 million jobs in this country were related in some way to providing food and fiber production, representing nearly 17% of gross national product. In short, prosperity in agriculture—in a system of diverse competitive family farms, through which control of our food and fiber production rests in as many hands as possible—must be a cornerstone of any economic recovery plan.

This must also be the foundation of any concerted effort to bring new farmers into the business of agriculture. Without profit potential, tax incentives for first-time farmers will take us backwards to pre-1986 tax changes by attracting primarily those individuals seeking to offset profits from some other business with losses in farming.

Having said that, there are several tax policy changes which, if enacted, could foster continuation of family farm agriculture and help bring about sustainable economic recovery. From income taxes to excise taxes to estate and gift taxes, we have woven a complex web for which a farmer needs a tax attorney in the family to stay competitive with his neighbors and, just as importantly in these days of free trade negotiations, to stay competitive with farmers of other nations.

Though by no means exhaustive, our list includes the following ideas:

1. *Any new income tax bill*—Any new income tax measure ought to begin by recognizing that the Omnibus Reconciliation Act of 1990 has done little to reduce the federal budget deficit, yet serves as a major obstacle to passage of meaningful legislation on either the revenue or spending side. We are not suggesting that the country give up on gains made in that legislation toward a more progressive tax structure. In fact, we would urge adding additional tax brackets at the highest income levels to make our tax system even more progressive. Neither are we suggesting that the country give up on getting its financial house in order, but we would like to see the Congress make one more try at breaking down the firewall that prevents savings in one budget area from being used in another. Savings from reductions in defense spending must be made available to meet domestic needs, such as education, health care, job training, and job creation— for farmers and for other Americans. Savings from programs such as a two-tiered supply management program to stabilize the dairy industry should be available to offset the impact on food assistance programs, particularly Women, Infants, and Children. We do not recommend using defense savings to provide minimal tax cuts—it is more important to create jobs that bring more taxpayers onto the rolls and allow more consumers to pay fair prices for food and fiber.

2. *Some type of income averaging*—The inability for any type of income averaging affects young people going from full-time education to their first jobs. It affects senior citizens, as they retire from full-time employment to a smaller fixed income. And,

in volatile industries such as agriculture, the lack of income averaging leaves those taxpayers with even less ability to plan their business management strategies.

We recognize, though, that the old pre-1986 form of income averaging has its limitations now that there are fewer tax brackets. What we would recommend instead would be either or both of (1) a three-year "carry forward" provision for personal exemptions and standard deductions that are of little or no benefit to a taxpayer in a particularly low-income year or (2) a limited restoration of the old income averaging targeted only to those taxpayers who had sustained a within the three prior years, and based on adjusted gross income rather than taxable income (which failed to consider instances in which income fell below the amount that would be exempt from tax anyway due to personal exemptions and standard deductions).

3. Expand the investment tax credit, but target its use to investments in American-made products—Farmers are not the only small businessmen who have been waiting for better times to replace worn out equipment, but they provide an excellent example. A new tractor can cost anywhere from $40,000 to $130,000—15,000 to 50,000 bushels of corn, given USDA's projections for corn prices in 1992. Very few farmers will be buying new tractors in 1992 if they can possibly help it.

If farmers could afford somehow to invest in new tractors, somewhere steel workers, tire manufacturers, glass workers, and equipment dealers would benefit. But, for the U.S. economy to be the ultimate winner, that tractor should be built of American steel, running on American tires, with the farmer looking at his crop through an American window. It is time to invest American tax dollars directly into American jobs. This is not an attempt to bash any other nation's producers. If anything, it is simply a recognition that access to the U.S. market will mean more when Americans are fully-employed and have greater disposable income.

4. Deductibility of health insurance premiums—Health insurance premiums should be fully deductible for self-employed individuals, and the deduction should be a permanent part of the Internal Revenue Code. Too many farmers cannot afford to carry health insurance, despite the fact that farming is one of the most dangerous occupations in the country. Health care reform appears to be a rallying cry for both parties in this election year, and improvements eventually may come out of the campaign debate. But, the premium deduction is too important to leave at risk, and the best way to "depoliticize" it is to make the deduction permanent.

As a matter of simple fairness, deductions for self-employed individuals should be no less than deductions allowed for other employers. As a matter of encouraging jobs and economic growth, incentives for entrepreneurship, including new farms, allowing full health insurance premium deductions makes sense.

5. Transfer taxes on traded stocks and commodity futures—The last two budget proposals from the Bush administration have included the idea of imposing a transfer tax or user fee on traded stocks and commodity futures. We believe that this is an idea whose time has come, particularly in the case of agricultural commodities, where the funds raised could offset the costs of an improved crop insurance program.

The speculation frenzy of the last decade made millionaires out of people who never worked a day for the company whose stock they traded like baseball cards, and never produced a bushel of the wheat they sold. They have closed plants and cost jobs through leveraged buyouts, and they have wreaked havoc with commodity prices. It is time for these individuals to make a positive contribution to the U.S. economy—even if the funds are used primarily to offset the costs of the Securities and Exchange Commission and the Commodity Futures Trading Commission.

In agricultural commodities, one of the greatest opportunities for speculative profit comes in times of natural disaster. For traders, a short crop means higher prices and profits. For farmers caught by the natural disaster, a short crop often means financial ruin. Crop insurance has had limited success in helping farmers protect themselves from routine losses, and it was never intended to handle widespread disasters. The money for comprehensive disaster assistance legislation has been extremely tight, as witnessed this year, as farmers are even now beginning to receive disaster assistance checks amounting to pennies on the dollar of their actual loss. Why not ask those who benefit the most from commodity disasters to help those most severely affected?

6. Overturn the 1988 Supreme Court decision in the Arkansas Best Corp. v. Commissioner case—Congress should either enact legislation overturning the 1988 decision, or it should at least clarify the interpretation being given by the Internal Revenue Service. At issue is whether traditional hedging activities, the type of market-oriented risk management in which farmers have been so encouraged to engage by the last two farm bills, should receive the same capital gains treatment that speculators receive or whether the gains and losses from hedging activities should be seen as ordinary income or losses. Because capital losses are deductible only against cap-

ital gains, capital treatment of hedging losses can reduce substantially the after-tax profit of a farmer trying to reduce the risks he faces selling his crop or livestock in the cash market.

7. *Reject any additional excise taxes*—These regressive measures fall disproportionately on the poor and on small businessmen, such as most farmers, who buy their inputs at retail but sell their production at wholesale. Further, several of the these taxes are intended as much to reduce demand for certain agricultural products, such as tobacco and grains used in distilling alcohol, as they are to raise revenues.

We also oppose any further increases in the gasoline tax, even though farmers can obtain refunds of gasoline excise taxes for gasoline used on the farm. Rural citizens must drive farther for basic services, and public transportation options are limited, at best.

8. *Reject an across-the-board cut in the capital gains tax rate, except for the limited purpose of passing a small business, such as a farm, to a new generation*—In general, while all taxpayers with capital gains income could take advantage of a cut in the capital gains tax rate, far and away the largest benefits would accrue to the wealthiest taxpayers. The Congressional Budget Office has estimated that in 1988, the richest 1% of the nation's households had average capital gains income of $156,000, while the remaining 90% had average capital gains income of $252. One need not hold a Ph.D. in economics to see who would benefit most from a capital gains tax cut, and one need not be a farmer to recognize that nothing grows from the top down, including the economy.

In agriculture, most capital gains are realized when a farmer sells out. Farmers Union would prefer to concentrate on tax measures that will help farmers stay in business. This country needs more people on the land, not fewer. However, there are far more farmers over the age of 60 than there are under the age of 30 in the United States. Young people are understandably shying away from taking over the family farm or otherwise getting started in production agriculture. Older farmers looking forward to retirement are realizing that their lifetime's achievement is worthless if no one can take over. Interest rates in private banks remain fairly high on farm loans, a risk factor likely to remain until something is done about farm profitability. The Farmers Home Administration, traditionally the lender of last resort, has seen its direct lending funds reduced to near oblivion.

It is time to become creative in seeking new ways to get the next generation of farmers on the land. Reduction, or even forgiveness, of capital gains taxes is worth exploring for this limited purpose.

9. *Other retirement measures*—For many farmers, the equity built up over a lifetime on the family farm has been the primary source of retirement funds, and this is true of other small business owners, as well. We would recommend this Subcommittee's consideration of legislation allowing small business owners to treat a portion of equity in a family-owned business as qualified contributions to an Individual Retirement Account (IRA). In addition, we would recommend restoring the full $2,000 deduction for IRA contributions, regardless of the taxpayer's income level.

In addition, we urge you not to accept any future proposals for encouraging early withdrawals from IRA's by reducing penalties. We cannot accept a plan that allows people to wipe out their retirement savings and then claims that we've addressed the high cost of education and health care, or the inability of so many middle income Americans to save up a down-payment for a home. We need to solve those problems head-on, not mask them by creating another problem down the road as people try to get by in their retirement without the proceeds of their IRA's.

We also urge you to reject any proposals that may be forthcoming to tax accruing interest on annuities unless two-thirds of the annuity value is placed at risk. Purchasers of annuities tend to be middle-income individuals with little or no pension to fall back on in retirement, such as farmers. They are seeking a secure investment, a long-term savings plan funded with after-tax dollars that provides capital for other investments. Since accrued interest on annuities is taxed eventually, any short-term revenue gains from such a proposal must be measured against long-term revenue drops from fewer annuities being purchased.

Finally, we urge you to reject any proposal to eliminate the deductibility of interest paid on loans secured with business-owned life insurance. Many small businesses, including farms, rely heavily on business-owned life insurance to guard against the income lost should something happen to a key employee. Many lenders now require farmers to buy this type of insurance as a condition to receiving a loan. The ability to borrow against the policy and deduct the interest on the loan at least adds a degree of flexibility and a "last resort" in meeting unexpected cash flow needs of the farm operation—including the costs of passing the farm to the next generation.

10. The tax consequences of debt restructuring—Ever since Chapter 12 of the Bankruptcy Code was enacted, and even more so since the passage of the Agricultural Credit Act of 1987, farmers have been working their way out of financial problems with their creditors, only to discover that a debt write-down could leave them having to sell their farms anyway to satisfy the Internal Revenue Service. National Farmers Union supports S. 900, which would address much of this problem. With another round of delinquency notices to be sent out by the Farmers Home Administration shortly, we urge this Subcommittee to move aggressively on S. 900.

11. Parity giving—I suppose that I will end my testimony the way I began it—farmers need income. One way to build markets for agricultural commodities, while at the same time meeting other social needs, is through the concept of parity giving. As proposed, any taxpayer (including a farmer) who donates an agricultural commodity, such as cheese, to a qualified organization, such as a soup kitchen, is allowed to deduct the parity value of that commodity as a charitable contribution, regardless of the actual basis price. Farmers win by increased demand, low-income consumers win by increased donations, and the taxpayers involved win by getting higher deductions.

I have covered quite a bit of ground today, Mr. Chairman. I would be happy to address any questions you might have either at this time or more fully in writing for the hearing record.

Thank you.

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An Analysis of Competitive Advantage Between the United States, Canada, and Australia for Wheat Production

Agricultural Experiment Station
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AN ANALYSIS OF COMPETITIVE ADVANTAGE BETWEEN THE UNITED STATES, CANADA, AND AUSTRALIA FOR WHEAT PRODUCTION

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AN ANALYSIS OF COMPETITIVE ADVANTAGE BETWEEN THE UNITED STATES, CANADA, AND AUSTRALIA FOR WHEAT PRODUCTION

The purpose of this study is to suggest how tax policy, key social programs, government farm programs, and relative costs of production impact the profitability of wheat farms in the United States, Canada, and Australia. These three countries were selected for analysis because: (1) They represent three of the five major wheat exporting countries in the world (the other two being the European Community and Argentina); (2) all three countries are major exporters to the Asian wheat market, which represents the largest potential future market for wheat exporters; and (3) all three countries operate under similar legal and tax systems. Further, English is the major language spoken in each country, facilitating a comparative analysis.

The focus of this research is at the farm level and, in particular, deals with wheat-fallow farming systems in all three countries. The introductory section provides background and motivation for the study. After the introduction, a detailed comparison of production costs, government farm programs, tax policy, and nongovernment social programs is provided for all three countries. This information is then incorporated into a simulation model to estimate net returns to representative farms in each country. Sensitivity analysis is then used to better understand how government tax and social policies provide competitive advantages in trade.

Introduction

Since the close of World War II a major effort has been made by countries throughout the world to reduce barriers to trade. Greater trade leads to specialization in production of goods based on ones natural comparative advantage. The result is increased overall productivity and greater societal welfare than occurs with complete self-sufficiency.

Of course, specialization brings with it a number of potential problems. Complete dependence on trade for essential goods (such as food and fuel) can jeopardize the recipient nation's national security, leaving it quite vulnerable to blackmail by the supplying country. Elimination of a non-competitive industry can be painful for some segments of a society and may generate a political backlash (if these groups don't want the industry eliminated). In addition, governments may intervene to provide subsidies that offset the natural disadvantages faced by a noncompetitive advantage. Governments may also provide additional support to an industry with a comparative advantage in production and trade, to enhance market share or meet some social goal.

Trade negotiations are designed to reduce or eliminate factors that provide competitive advantage in trade, leaving the marketplace to determine where commodities should be produced. Perhaps the foremost vehicle used to reduce trade barriers is the General Agreement on Tariffs and Trade (GATT). This agreement provides a mechanism for negotiating the removal of trade barriers between countries. Agriculture is one of the

industries provided substantial protection by countries throughout the world. Consequently, agricultural subsidies are among the most discussed topics in virtually every "round" of GATT negotiations. And because most countries seek to maintain some degree of self-sufficiency in agricultural production, these subsidies have been among the hardest to eliminate.

Much of the focus in the GATT trade negotiations has been on direct and indirect subsidies provided by each country to its farmers. A useful tool in measuring relative subsidy levels across different countries is the Producer Subsidy Equivalent (PSE). Table 1 contains PSE and CSE (Consumer Subsidy Equivalents) values for wheat production in the major wheat exporting countries. The PSE values reflect all direct payment subsidies received by farmers (including income support payments, transportation, and other input cost subsidies), as well as the value of services provided to farmers (e.g., extension personnel, research expenditures). The idea is that competitive advantages in trade provided by government will be eliminated when these types of subsidies are eliminated by all countries.

The elimination of these types of subsidies may not eliminate government's influence on trade competitiveness, however. Completely ignored in these trade negotiations has been the influence of tax policy. Yet, there are good reasons why tax policies should be should be given equal consideration with traditional farm subsidies in trade negotiations. First, taxes represent another form of government interaction with farm businesses and, as such, can have as much influence on trade competitiveness as direct farm subsidies. As an example, farmers who receive substantial subsidies but also pay high taxes may be in the same after-tax financial position as farmers in another country who receive no subsidies, but have much smaller tax obligations. Second, focusing on the PSE as a measure of government intervention may not cause the reduction of subsidies, but may instead cause some governments (who find it desirable to subsidize their fanners) to switch to tax policy as their subsidy vehicle. Including taxes in trade negotiations will ensure they are not used to circumvent trade agreements.

Tax revenues are used to provide a number of other services in addition to agricultural subsidies. Many of these services, however, also contribute to trade competitiveness. Any government program that subsidizes the farmer's standard of living (e.g., government health insurance) or reduce the farmer's total tax burden allows him (or her) to lower the acceptable rate of return, thereby enhancing trade competitiveness. Consequently, government services should also be considered in any comparison of tax burdens between countries.

Other researchers have recognized the importance of tax policy on competitiveness in trade. Sharples (1990) argued that policies to reduce tax burdens on farmers were one of several ways in which government could make commodities more competitive in international markets. A recent study of the U.S. - Canada Free Trade Agreement by researchers at Agriculture Canada also recognizes the importance of tax policy in trade and suggests that more research is needed to quantify the tax burden faced by farmers in both countries (*Growing Together*, 1990).

Table 1. Wheat Producer and Consumer Subsidy Equivalents for Major Wheat Exporting Countries 1982-1987.

Producer Subsidy Equivalents	1982	1983	1984	1985	1985	1987
Argentina	-35	-51	-64	-26	-7	6
Australia	9	4	3	5	15	4
Canada	19	23	32	39	53	51
EC	27	10	4	31	59	55
United States	15	38	28	39	61	63
Consumer Subsidy Equivalents						
Argentina	---	---	---	---	---	---
Australia	---	---	---	---	---	4
Canada	-1	-1	-1	-1	-1	-1
EC	-23	-7	-2	-24	-50	-46
United States	0	0	0	-3	-10	-23

Source: Webb, Lopez, and Penn (1990)

Descriptive Cross Country Comparisons

General Description of Study Areas

Table 2 provides a general overview and specific characteristics of the three representative farms. Typical production practices were identified by talking with farmers, extension agents, and economists in each area. All prices and costs in the paper (unless otherwise indicated) are reported in U.S. dollars using the exchange rates $1 US = $1.18 CDN = $1.27 AUS.

The United States and Canadian farms were placed in adjoining counties (Toole County, Montana and Warner County, Alberta) to minimize differences in soil type, topography, and climate. Spring wheat is the major grain grown in both counties. Durum and Hard Red Spring wheats dominate in Warner County, with Hard Red Spring dominating in Toole County. Severe winters and poor snow cover make winter wheat a riskier crop. Barley is also grown in both counties as part of a wheat-barley rotation, but lower profit margins limit its acreage. Rainfall variability is great and causes farmers to anticipate a crop failure in two or three years out of ten.

In Australia, most wheat farms are part of a substantial livestock operation. The tax treatment of livestock operations is somewhat different than that for grain operations. To facilitate a clear comparison of tax law in each country, the Australian farm was assumed to focus on grain production only.

Costs of Production

Table 3 summarizes production costs for the major inputs used on each study farm. A number of inputs can be purchased on either side of the U.S.- Canadian border for the same price, including seed, farm equipment, tools, and equipment parts. Fertilizer costs are relatively close for the United States and Canada, with Australian farmers paying substantially more. Wholesale prices for diesel in the United States and Canada are approximately the same. All three governments waive a portion of their fuel taxes for farmers, although the higher tax in Australia leaves their fuel costs at a much higher level. The result is a distinct cost disadvantage for Australian wheat farmers. Australia imports most of its petroleum products and uses taxes as a means of reducing consumption.

Most agricultural chemicals are manufactured in the United States; consequently, prices are lowest there. In addition, both Canada and Australia levy duties on importation of chemicals, making their cost somewhat higher. The U.S. - Canada Free Trade Agreement calls for elimination of these duties in Canada.

Labor costs are lowest in the United States, with costs in Canada and Australia being roughly the same. The greater availability of transient labor, with its low overhead costs, contributes to lower U.S. agricultural wages. Higher labor overhead and general living expenses (both influenced by government trade and agricultural policies) were cited as reasons for higher Canadian and Australian wages. A detailed discussion of marketing costs is deferred to the section on government farm programs.

Table 2. Summary of Crop Production Information by Country

	United States	Canada	Australia
Location	**Toole County Montana**	**Warner County Alberta**	**Moree District New South Wales**
Crop Mix (acres)			
Spring Wheat	700	400	1500
Durum Wheat	0	470	0
Winter Wheat	50	80	0
Barley	300	100	500
Fallow	1050	1050	0
Total Acres	2100	2100	2000
Crop Yield (bu/ac)			
Spring Wheat	Mean 30.0 Std D 11.0	Mean 30.0 Std D 11.0	Mean 35.9 Std D 19.0
Winter Wheat	Mean 35.0 St D 13.0	Mean 35.0 St D 13.0	------ ------
Barley	Mean 45.0 St D 19.0	Mean 45.0 St D 19.0	Mean 39.9 Std D 19.4
Crop Price ($US/bu)			
Durum Wheat Location	------ ------	Mean 4.02 St D 0.75 Vancouver, B.C.	------ ------
Spring Wheat Location	Mean 4.45 St D 0.60 Portland, Oregon	Mean 3.79 St D 0.75 Vancouver, B.C.	Mean 3.78 St D 0.66 New Castle, New South Wales
Winter Wheat Location	Mean 4.34 St D 0.59 Portland, Oregon	Mean 3.79 St D 0.75 Vancouver, B.C.	------ ------
Barley Location	Mean 2.18 St D 0.33 Montana	Mean 1.60 St D 0.38 Lethbridge, Alberta	Mean 3.02 St D 0.67 New Castle, New South Wales
Spring Wheat			
Planting	April	April	May
Harvest	Aug-Sept	Aug-Sept	Nov-Dec

Table 3. Selected Cost of Production Estimates for Wheat in Each Country (1990 $US)

Item	Unit	US	Canada	Australia
Seed	bushel	4.68	4.68	4.73
Fertilizer	Unit of N	0.152	0.22	0.34
Gasoline	gallon	1.23	1.13	2.42
Diesel	gallon	0.875	.78	1.38
2-4-D	gallon	11.95	13.15	14.35
Marketing Costs (Wheat)				
Storage	bushel/yr.	0.36	0.102	0.096
Shipping to Port	bushel	0.75 (600 miles)	0.24 (720 miles)	0.50 (270 miles)
Handling	bushel	0.0	0.33	0.226
Other Costs	bushel	0.0	0.31	0.075
Interest				
Operating	percent	11.5	15.0	20.0
Equipment	percent	11.25	11.9	12.9
Land	percent	11.25	9.0	20.0
Inflation Rate	percent	4.7	6.0	8.1
Insurance				
Crop	$100 value	3.45	3.70	6.00
Equipment	$1000 value	5.00	2.60	10.42
Liability	$1 million value	783.00	47	85
Labor	Hour Month	5.00 1500	5.50 1600	5.50 1550
Farm Equipment Case-IH	4994 tractor 1660 combine	100,000 92,700	100,000 92,700	146,150 142,200

Both nominal and real open market interest costs in Canada and Australia are higher than rates on similar loans in the United States, but for different reasons. In Canada, high federal deficits necessitate high interest rates to encourage purchases of government bonds. Interest rates are high in Australia because of their reliance on monetary policy. In addition, Australia suffers from a higher inflation rate than the United States and Canada.

Governments in all three countries have provided programs to reduce interest costs to farmers. The most accessible of these programs, until its cancellation in 1990, was the Alberta Farm Credit Stability Program (AFCSP). This program provided up to $212,500 at a 9 percent annual interest rate to virtually any farmer for purchases of land, equipment, or consolidation of debt. Loan terms were 20 years for land and 10 years for equipment[1]. Alberta provided over $2 billion for this program between 1986 and 1990 (Government of Alberta).

Farmers Home Administration (FmHA) functions as a lender of last resort for farmers in the United States, providing operating and, occasionally, land purchase monies at below market interest rates. The FmHA program continues to be scaled back in size, making it difficult for more than a handful of farmers in each county to annually qualify for loans. In addition, Montana has a small (less than $250,000/year) interest subsidy program for farmers. Australia's interest subsidy program is about on the same scale as that for Montana.

Crop insurance is subsidized in Canada and the United States. The costs are similar on both sides of the border, but the U.S. program provides greater flexibility for the farmer. The U.S. farmer can select from three different yield guarantee levels (versus two in Canada), three different price elections (only one provided in Canada), and may use historical yields as a basis for calculating insured yield levels (Seubert 1989). Australian crop insurance is provided through private industry and is not subsidized.

Farm equipment can be freely purchased and brought across the U.S. - Canadian border. Consequently, prices are assumed to be the same. In Australia, major items of farm equipment such as tractors and combines are all imported from the United States, Canada, and Japan. Shipping costs and high dealer markups make this imported equipment much more expensive for Australians. Some Australian farmers reduce their equipment costs by travelling to the United States, purchasing their equipment here, and shipping it back to their home country.

In summary, production costs are slightly lower in the United States than Canada, and are substantially less than costs in Australia. High fuel and equipment costs, combined with roughly equivalent labor costs, encourage Australians to focus on agricultural activities that require much land. Consequently, beef and sheep production, and broadacre grain production are the mainstays of Australian agriculture. Inexpensive capital goods (particularly farm equipment) tend to favor crop production over grazing livestock in the United States. Canadian agriculture tends to favor livestock production, primarily because climate and soils

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[1]AFCSP loans on equipment were generally limited to consolidation of existing debt on several pieces of equipment into one loan.

limit the profitability of grain production. In the study area, however, grain production is generally more profitable than livestock alternatives.

Family Living Expenses

Economists refer to the set of items purchased by an individual or family during a time period as a "basket of goods". Prices of these items vary somewhat between the three subject countries, causing the basket of goods to also vary. The total cost of each basket of goods (referred to here as family living expenses) must be estimated for each country because sales tax on these purchases is an important component of total taxes paid. Ideally, one would identify the basket of goods purchased in each country such the farmer (as a consumer) is indifferent as to which basket he (or she) would prefer. In practice, however, estimating what the basket would be in each country is difficult and very expensive. Even data indicating the typical basket of goods purchased by households in a particular area of the United States or other countries are difficult to obtain.

To address the question of living expenses, estimates of expenditures by category were made for a typical farm family of four living in Toole County, Montana. These expenditures are reported in Table 4, along with associated sales and fuel taxes. The coauthors from Canada and Australia (both of whom have lived in the United States) were asked to estimate what this same basket of goods would cost if purchased in Canada and Australia. The Canadian and Australian estimates are also given in Table 4. A quick comparison reveals that living expenses in Canada and the United States are similar, with Australian expenses being about $350 higher per month.

Government Farm Programs

The Australian government provides little in the way of government programs for its farmers. By contrast, both Canadian and U.S. governments spend billions of dollars on special programs for agriculture. Consequently, government farm programs substantially impact on the profitability of grain farms in Canada and the United States, although the impact is different in each country.

The U.S. farm program focuses on commodity prices and supply controls. The Commodity Credit Corporation (CCC) loan program provides farmers with a ready cash income at harvest. In addition, the CCC loan acts as a pseudo-price floor, meaning farmers may forfeit grain ownership to the government to satisfy their debt. Each U.S. farmer also receives up to $50,000 per year in deficiency payments if market prices do not exceed target levels set by Congress. The U.S. government typically requires farmers to forego planting a percentage of their farm acreage base to qualify for most farm program benefits.

The U.S. government also provides other benefits to grain farmers. Barge transportation on some river systems (such as the Columbia) is subsidized. All-risk crop insurance is subsidized heavily. In addition, the U.S. government has at times provided other programs to benefit farmers (e.g., Conservation Reserve Program, disaster payments). The provisions outlined in the 1991 U.S. Farm Bill suggest agriculture will continue to receive fewer and

Table 4. Monthly Living Expenses by Item for US Farmer and Corresponding Expenditures in Canada and Australia

	United States		Canada		Australia	
Item	**Cost**	**Tax**	**Cost**	**Tax**	**Cost**	**Tax**
Housing	0	.00	0	.00	0	.00
Food	350	.00	410	3.00	486	4.00
Utilities	105	.00	102	7.14	65	.00
Family Vehicle						
Payment	469	6.00	488	34.00	474	70.00
Insurance	50	.00	43	.00	40	.00
Fuel	54	21.00	50	75.00	60	87.50
Clothing	150	.00	150	10.50	166	.00
Furniture	150	.00	150	10.50	155	10.00
Entertainment	150	.00	150	10.50	330	.00
Medical		.00				
Insurance	200	.00	63	0.0	38	.00
Out-of-Pocket Costs	40	.00	40	0.0	40	.00
Miscellaneous	100	.00	100	7.00	300	30.00
Total	$1,818	$27.00	$1,746	$157.00	$2,154	$197.50

fewer subsidies from the federal government. The 1991 Toole County target price, for example, has been reduced to $3.99/bushel and farmers receive deficiency payments on only 80 percent of eligible acreage.

The centerpiece of Canadian farm policy for grains is the Canadian Wheat Board (CWB), which controls the sale of all exported wheat and barley. The Canadian government (through Parliament) sets an initial price at the beginning of the crop production period, generally based on 80 percent of the price the CWB expects to receive for its grain. Supplemental and final payments are made to farmers if the actual price exceeds this initial price level. If final price does not exceed initial price, the Canadian government makes up the difference.

Although (in theory) sales restrictions are in place to discourage overproduction of Canadian wheat and barley, the method of calculating these restrictions is sufficiently flexible to allow most wheat-fallow farming operations the freedom to allocate acreage among any crop. The estimates in Table 3 suggest there are substantial handling and other marketing costs for Canadian wheat. The other costs are imposed by the Canadian Wheat Board to cover their operating expenses.[2] Handling charges are levied by the Alberta Wheat Pool (Hansen, 1991).

In 1991 the Gross Revenue Insurance Program (GRIP) replaced the Western Grain Stabilization Program as a means of stabilizing farmer's incomes. GRIP is a voluntary income insurance program, with insurance premiums calculated as some portion of target income. Target income is the product of average yield (as calculated for crop insurance) multiplied by 70 percent of long term price. Long term price is a fifteen year average of provincial prices, lagged two years and inflated to current dollars using a producer price index (0.70 x $4.99/bushel). As an example, the target price for hard red spring wheat in 1991 is $3.49/bushel. If target income exceeds actual income (including expected crop yield insurance indemnities), an indemnity is paid to the producer.

The cost of shipping grain to port is subsidized by the Canadian government. As a consequence, the price differential between Warner County and Vancouver is $0.24/bushel for wheat. By contrast, the price differentials between Toole County and Portland, Oregon are about $0.75/bushel for wheat.

The Province of Alberta also provides a number of production cost subsidies to their farmers[3], aside from the AFCSP. For example, the Alberta Agricultural Development Corporation offers a number of financial programs similar to those administered by FmHA in the United States. The Alberta Farm Fertilizer Price Protection Plan also provides rebates on nitrogen and phosphate costs. In addition, the Permanent Cover Program (like the Conservation Reserve Program in the United States) provides farmers with cash payments to retire highly erodible acreage from production.

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[2]These operating expenses include carrying charges, keeping the St. Lawrence seaway open, and administration costs.

[3]The value of these subsidies has already been reflected for costs reported in Table 1.

Australian farmers market their grain through the Australian Wheat Board (AWB). Unlike its Canadian counterpart, however, the AWB provides revenues to farmers consistent with revenues from grain sales. A payment is made approximately three weeks after harvest representing about 65 percent of anticipated revenue. An additional 25 percent is received approximately three months later, with the remaining 10 percent received over the next four years. The Australian government provides essentially no direct subsidies to its wheat farmers. An exception was in 1986, when some $250 million dollars was spent to provide a guaranteed minimum price for wheat. Although 1990-91 wheat price is near 1986 levels, no plans are being made to provide a similar subsidy.

Government Tax Policy

The income tax is the largest source of revenue to federal governments in Australia, Canada, and the United States. Canada and Australia also rely on sales taxes to generate revenue for both state (provincial) and national government, whereas in the United States most sales tax revenues are generated at the state level. Fuel and property taxes are also an important income source for governments in all three countries.

Tax reform has been continuous in all three countries during the past decade. Conservative governments have been dominant during much of this time and changes in taxes have generally reflected a conservative philosophy. Tax rates have generally been lowered and tax brackets reduced in the belief that lower income tax rates will spur productivity. An exception has been in Australia, where taxes have not been reduced as much as in Canada and the United States. Australia has, however, been able to generate budget surpluses during much of the 1980's by cutting some government programs such as those for agriculture.

•Federal Taxes

A comparison of federal tax laws of each country is given in Table 5. Both Canada and Australia provide one tax schedule for individuals and a second for corporations. The United States, by comparison, provides four different schedules for individuals: (a) Married filing jointly, (b) married, filing separately, (c) head of household, and (d) single. Regular U.S. corporations are subject to a separate, progressive tax schedule. The clear incentive provided by a single, progressive tax schedule is to have both husband and wife generate income for the family, thereby having the family's income taxed at an overall lower rate. Income splitting can be easily accomplished in a farming situation by creating a husband-wife partnership for tax purposes, with each spouse sharing equally in any proceeds from the farm[4]. A similar income-splitting husband-wife partnership in the United States would enable each spouse to pay taxes under the married filing separately category, resulting in approximately the same tax federal obligation as would have occurred had they filed their taxes jointly.

[4]The major requirement for partnerships in both Canada and Australia is that both each partner provide labor, financial capital, or assets in proportion to their share of farm income.

Table 5. Federal Tax Rates and Tax Brackets for Australia, Canada, and United States

Federal Income Taxes	Australia	Canada	United States
Individual Rates	4029 or less 0 4030-13,944 21% 13,945-16,274 29% 16,275-27,650 39% 27,651-39,500 47% 39,501 or more 48%	24,466 or less 17% 24,467-48,933 26% 48,934 or more 29%	17,000 or less 15% 17,001-41,075 28% 41,076 or more 31%
Husband and Wife Rates	Same as individual. Up to $948 deducted from taxable income if spouse not employed.	Same as individual. Up to $832 tax credit if spouse not employed.	34,000 or less 15% 34,001-82,150 28% 82,151 or more 31%
Corporate Rates	39%	38% rate, reduced to 12% if qualify as small business	52,400 or less 15% 52,401-78,600 25% 78,601-104,750 34% 104,751-351,000 39% 351,001 or more 34%
Surtax	None	For individuals 5% of tax when tax is less than 10,625. 10% of tax if over 10,625. For corporations 7% of tax.	None
Government Retirement (self-employed)	None	4.6% of first $25,925 of earned income.	12.4% of first $53,400 or earned income
Medicare (self-employed)	1.25% of taxable income if above $8161	None	2.9% of first $125,000 of earned income
Sales Tax	10%-30% tax on wholesale price	7% on retail price	None

Canada and the United States have only three tax rates for individuals, with a top rate of 29 percent in Canada and 31 percent in the United States. Surtaxes are also levied on regular Canadian taxes, resulting in a effective top tax rate of almost 32 percent[5]. Australia has a much more progressive tax system and, at 48 percent, a much higher top rate. Note, however, that the federal government in Australia collects essentially all income tax dollars, whereas both Canada and the United States have substantial state income taxes. Each country has some important distinctions in treatment of corporate taxes. Both Canada and Australia have a flat tax rate for corporations, whereas in the United States corporations are subject to a progressive tax rate system with five different tax brackets. A widely recognized disadvantage of incorporation is double taxation of revenues. Double taxation means the corporation pays tax on its profits and then distributes these profits as taxable dividends. Australia taxes corporations (companies) at a flat 39 percent rate. In Australia, dividend imputation allows the individual to avoid double taxation. For example, if the individual receiving the dividend was in the 47 percent tax bracket, they would receive a 39 percent tax credit on each dollar of dividends received, resulting in an additional tax payment by the individual of eight percent (Miller, 1990).

In Canada, corporations are taxed at a 38 percent flat rate. If the corporation has less than $170,000 in taxable income, however, it qualifies as a small business and receives a federal tax abatement of 10 percent and a small business deduction of 16 percent, resulting in an effective tax rate of 12 percent.

The United States provides for two different types of corporations, referred to as "S" and "C" corporations. The S corporation is essentially treated like a partnership for tax purposes, so will not be considered in this study. C corporations are subdivided into regular or personal services corporation. Farms typically qualify as regular C corporations. Tax rates for regular C corporations range from 15 percent to 34 percent.

Both Canada and the United States generate tax revenues separately for government retirement programs. In 1991, Canadians pay 4.6 percent of their self-employment income, up to a maximum of $1,192 (e.g., income above $25,925 is not subject to this tax). In the United States, self-employment income is taxed at a 12.4 percent rate on the first $53,400 of income. Salaried and hourly workers pay tax at 50 percent of these rates, with the other 50 percent paid by employers. Australia covers its government retirement program out of general tax revenues.

Australia and the United States levy taxes to pay for indigent and elderly medical care. In Australia, this tax is 1.25 percent of taxable income, if income exceeds $8,161 (adjusted for number of dependents). The United States levies a 2.9 percent tax on the first $125,000 of self-employment taxable income. Canada pays for this form of medical care through federal and provincial taxes.

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[5] There is a personal exemption phase-out in the U.S. for high income taxpayers which effectively increases the top rate.

Canada and Australia also levy federal sales taxes. Australia's tax is on the wholesale price of goods and is aimed primarily at imported goods. Tax rates are 30 percent on luxury goods (such as sports cars, jewelry, VCRs, etc.), 20 percent on regular goods (such as motor vehicles, computers, alcoholic beverages, etc.), and 10 percent on some household goods (such as furniture, snack foods, water heaters, bathroom fittings, etc.). Food, medical care, books, utilities, and agricultural inputs are exempt from wholesale tax (Australian Taxation Office). Canada implemented its seven percent General Sales Tax (or GST) on January 1, 1991. The tax covers virtually every kind of expenditure in Canada, except regular food and medical care. The GST is refundable on most goods purchased for agricultural production. Estimates of sales taxes in Australia and Canada are given in Table 4.

All three countries levy substantial taxes on fuel purchases. Most of these taxes are waived when the fuel is used in agricultural production. Data on all taxes levied on fuel are difficult to obtain, particularly in Canada and Australia. To estimate taxes for fuel used by households on a pre-tax basis, the monthly household fuel expenditure estimated by the Toole County farmer (see Table 4) was reduced by the federal and state tax amounts ($0.34/gallon). This cost was then used as a basis for estimating pre-tax fuel costs in Canada and Australia. The difference between what was actually paid for fuel and the pre-tax fuel cost was assumed to represent the fuel tax.

•State and Local Taxes

A summary of state/provincial and local taxation policies is outlined in Table 6. During World War II, Australia's states merged their income taxation system with the federal government. Consequently, no income taxes are levied at the state level. Property taxes (rates) are levied on land and buildings. The revenue is used to cover some local government expenses, but the tax is small compared to property taxes in Canada and the United States.

Montana has no sales tax, so it must depend on income and property taxes to fund government services. State income tax is the major government revenue source in Montana. A single, highly progressive rate schedule is used for all taxpayers, with a larger standard deduction provided for couples filing joint returns. Property taxes are also levied on land, buildings, and farm machinery.

Canadian provincial taxes are generally collected by the federal government and are based on a percentage of federal tax payable. The marginal rates, however, are generally a larger percentage of the federal rates than in the United States. Property taxes are normally levied on land and buildings. A waiver is provided for most farm homes (McKeltine, personal communication). Farmers in Montana are required to pay 10.4 percent of estimated living expenses for worker's compensation insurance, with a minimum of $1,121/year. Because Canada and Australia provide medical care, disability payments and retraining for the injured farmer, disability insurance is not needed like it is in the United States.

Table 6. State and Local Tax Rates and Tax Brackets for Australia, Canada, and United States

State Income Taxes	Australia	Canada	United States
Individual Rates	None	46.5% of federal tax	1,600 or less 2% 1,601-3,100 3% 3,101-6,300 4% 6,301-9,400 5% 9,401-12,600 6% 12,601-15,700 7% 15,701-2,200 8% 22,001-31,400 9% 31,401-55,000 10% 55,001 or more 11%
Husband and Wife Rates	None	Same as individual	Same as individual
Corporate Rates	None	15% reduced to 6% if qualify as small business	6.75% of taxable income
Surcharge	None	8% of provincial tax over $2975	None
Property Taxes (per $100 market value)			
Farm Land	3.95	7.59	6.46
Home	3.95	exempt	7.69
Equipment	None	None	6.73
Worker's Compensation Insurance	None	Optional	10.4% of normal living expenses

•Special Tax Treatment Items

Table 7 provides a summary of items receiving special tax treatment in all three countries. Australia, Canada, and the United States provide preferential tax treatment for capital gains. In Australia, the purchase price for the capital gain item is indexed upward to the dollar value at time of sale. Consequently, individuals pay tax only on the real capital gain. Canada levies tax on nominal capital gains at 75 percent the regular rate. The United States taxes nominal capital gains at a maximum rate of 28 percent.

Depreciation allowances for tax purposes in all three countries have been modified numerous times during the last decade. Canada and the United States allow only one-half the annual depreciation allowance in the year of acquisition. In Canada, deduction of an allowance for the capital cost of depreciable property (capital cost allowance or CCA) is permitted in lieu of depreciation. Depreciable properties are pooled together in classes on the basis of their similarity in use. Annual capital cost allowances are deducted from the year-end balance of each class at rates that are class specific. In most cases, depreciation rates are applied on a diminishing-balance basis. Taxpayers may also claim less than maximum CCA and even vary the depreciation rate from year to year. There is no stipulated minimum and no requirement that the deduction be related to amounts claimed for financial reporting purposes. The basic depreciation rate is 30 percent of current depreciable basic for motorized farm equipment, 20 percent for non-motorized equipment, and five percent for buildings.

Depreciable assets in the United States are pooled by economic life, with most farm machinery being in the seven-year class. Once a method of depreciation (accelerated versus straight-line) is selected, a change in method is allowable only with approval from the Internal Revenue Service. Farm buildings are placed in a twenty-year class life. United States depreciation schedules also require no deduction for an asset's salvage value, thereby providing for a tax-writeoff of 100 percent of the purchase price. The United States also allows for some or all of the equipment purchase price to be expensed in the year of purchase. Total expensing for all durable assets cannot exceed $10,000 in a given tax year.

Australian farmers may choose between straight-line and diminishing balance depreciation schedules. Assets are assigned a straight-line (or prime cost) depreciation rate based on their use classification. If a diminishing value pattern is chosen, the rate is 50 percent higher than the straight-line rate. In addition, 20 percent loading rates apply to assets purchased after May 25, 1988. Loading increases the depreciation rates for both prime cost and diminishing value depreciation. For example, a 25 percent prime cost depreciation rate would increase to 30 percent under a 20 percent loading scheme, with the diminishing value rate increasing to 45 percent. Most self-propelled farm equipment purchased in 1991 would be depreciated (with loading and a diminishing value pattern) at a 27 percent rate, with other farm equipment depreciated at 18 percent. Farm buildings are depreciated at 5.4 percent.

Income averaging was eliminated during the 1980's for both Canada and the United States. Australia, however, permits a form of income averaging for primary producers (farmers and ranchers) only. A better description of the Australian approach is tax rate averaging. If averaging is selected, the farmer calculates the average tax rate for farm income earned in the

Table 7. Tax Preference Items and Non-Farm Government Programs in Australia, Canada, and United States

	Australia	Canada	United States
Depreciation (current law) Equipment	27% of current depreciable basis for motorized vehicles, 18% for other equipment	30% of current depreciable basis for motorized vehicles, 20% for other equipment	MASCRS depreciation schedule, 5 or 7 year life
Buildings	5.4% of current depreciable basis	5% of current depreciable basis	MACRS depreciation schedule, 20 year life
Capital Gains	Determined as real capital gain, taxed based on income formula	Taxed at 75% of regular income	28% if income is in 31% tax bracket
Income Averaging	Yes, average of average tax rates current plus last four years	Not available	Not available
Income Equalization/ Retirement Fund	Total fund balance limited to $197,500 per farmer. No penalty for withdrawal. Available to farmers only.	Registered retirement saving plan, deposits limited to $9350/year/person or 18% of taxable income. No penalty for withdrawal.	KEOGH Account, limited to 25% of earned income or $30,000. 10% tax penalty plus regular taxes in year of withdrawal (before 59 1/2 years of age)
Expensing	Not available	Not available	Up to $10,000 per year in year of acquisition
Investment Tax Credit	Not available	Limited to Eastern Canada provinces	Not available
Child Support Payments	Available for children under 18, based on number of children and ages. Maximum of $45.7/month/child. Phased out above $46,500 family taxable income. Tax exempt.	Available for children under 18, based on number of children and age. Maximum of $41.40/month/child. Must repay 2/3 if taxable income exceeds $44,000. Subject to tax.	Earned Income Credit, deducted from federal tax obligation. Maximum tax credit of $1,000 when taxable income is $7,125-$11,263. Credit is zero above $21,232 taxable income. Not influenced by number of children.
Exemptions	None	$876 tax credit for taxpayer, $65 each for first two dependents, $138 for each additional dependant	$2150 per exemption deducted from taxable income
Deductions	Excessive medical, non-religious charitable contributions deducted from taxable income	50% of CPP taxes, excessive medical, tuition deducted from tax at 17% of value. Charitable contributions deducted at 17% or 29% of value.	State income taxes, medical, charitable contributions deducted from taxable income if total exceeds $5,700. 50% of self-employment deducted as farm expense. Additional exemption at federal and state level if tax return is joint.

current and previous four years. These rates are then averaged and multiplied by current year's taxable income to obtain tax payable (Douglas, personal communication).

Tax-deferred funds are often used by farmers in all three countries to reduce tax obligations in high income years. The Income Equalization Deposit program in Australia allows farmers to deposit some of their income[6] in a government-sponsored tax-deferred account. The farmer can withdraw the money at any time with no penalty, but must report the withdrawals as taxable income. Total deposits in this program cannot exceed $197,500 per person (Tomes, 1991). This program was created in response to the high level of income variability faced by most Australian farmers.

The United States has a number of retirement programs that can be used by self-employed persons. A program commonly used by farmers is the tax-deferred KEOGH plan. Under this plan farmers can annually contribute up to 15 percent of their taxable income (maximum of $30,000) to a KEOGH account. In theory, KEOGH plans can be used like the Income Equalization Deposit program to stabilize income. In reality, they seldom fill this type of role because the government assesses a 10 percent tax penalty on early withdrawals (before 59 1/2 years of age). When combined with normal taxes assessed on the amount withdrawn, the cost of withdrawal before retirement is generally too high to justify its use for income stabilization purposes. Canada created the Registered Retirement Savings Plan (RRSP) to function much like a KEOGH plan. However, there is no tax penalty on withdrawal, allowing farmers to use the RRSP much like an income stabilization program. Deposits are limited to 18 percent of taxable income, or $9,350 per year.

All three countries provide special aid to middle and lower income families with children. Family allowance payments are made monthly to families in Australia and Canada based on income level and the number and ages of children. In Australia, regular allowance payments are $34/month/child for up to three children, then $45.70/month for each additional child. This program is phased out if a family with one child had a previous year's taxable income exceeding $50,000. Somewhat higher income levels apply for larger families. Only children under 18 qualify for this benefit. Australia also provides a supplement to the family allowance payment if income for a single child family is $16,400 or less. The supplement provides $90/month/child for those under 13 years of age and $132/month for children aged 13-15. All Australian family allowance payments are tax-free (Social Security, 1990).

Canada's family allowance payments are also limited to children under 18 years of age. Amounts range from $40.63/month/child for 16-17 year old children to $22.35/month/child for children under 7 years. Canadians are required to repay two-thirds of their allowance if taxable income exceeds $43,223. These payments are subject to tax (Good, personal communication). In addition, Canadians receive a child tax credit (above the standard exemption) of $489/year/child. This credit is phased out as taxable income (for the person claiming the children as dependents) exceeds $21,000.

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[6]The minimum deposit is $3,950 in any year.

The United States provides an Earned Income Credit (EIC) program to provide for low income families with children. EIC is calculated as a tax credit to federal income tax. The credit is at its maximum ($953) when earned income is between $6,800 to $10,750. The credit is zero for incomes above $20,264 or below $0. The EIC is the same regardless of family size. The credit cannot be claimed if a couple file their income taxes separately.

The treatment and value of personal deductions and exemptions is also quite different between countries. In the United States, taxpayers receive a deduction of $2,150 for each personal exemption and may deduct the cost of itemized deductions (medical expenses, nonbusiness interest and property taxes, state income taxes, and charitable contributions) if they exceed the standard deduction ($5,700).

Rather than itemizing personal deductions Canadian taxpayers are allowed to deduct 17 percent of medical expenses and tuition directly from federal tax payable. In addition, charitable expenses above $213 are deducted from taxes at 29 percent of their value. Tax exemptions for children in Canada vary by family size, with more generous benefits given to larger families. Rebates of the GST are provided for lower income families.

Australia generally provides no exemptions for family members besides the spouse rebate, which becomes available when one spouse earns less than $4,000/year in income ($3,382 if the couple have no dependent children). The rebate reduces taxable income by a maximum of $1,200. Limited deductions from taxable income are available for medical expenses or non-religious charities.

Methodology, Data and Assumptions

Modelling Approach

A farm-level simulation model was used to estimate the effects of agricultural policy, costs of production, and tax policy on farm profitability. The farm simulation model was developed at Oregon State University by Perry (unpublished manuscript). The model attempts to replicate the financial behavior of a farm over time, calculating monthly cash flow statements and annual income statements and balance sheets for each year simulated. Crop yields and prices of inputs and outputs can be randomized in a Monte-Carlo framework based on distributions provided by the user. A key part of the model output is the income statement. An example income statement is given in Figure 1. The income statement uses cash variable costs from the cash flow statement in combination with changes in asset values provided on the balance sheet to calculate the change in farm net worth. An abbreviated and slightly modified form of the income statement is used in presenting the simulation results.

The advantage of a simulation approach is the ability to analyze extremely complex situations over time and be able to sort out issues of importance to the decisionmaker. In this setting, tax policy is extremely complex and often contradictory within each country considered in the analysis, making it virtually impossible to determine which country's policies favor farm operators.

Figure 1. Example Income Statement from Farm Management Simulation Model (FAMS)

	1991
CASH FARM INCOME	
Crop Receipts	119392.
Direct Government Payments	0.
Crop Insurance Indemnities	24508.
Direct Government Loans	0.
Less: Repayment of Government Loans	0.
Other Farm Income	0.
Savings Interest	136.
TOTAL CASH RECEIPTS	144035.
CASH FARM EXPENSES	
Per Unit	0.
Materials	4080.
Chemicals	44800.
Fuel	6013.
Labor	0.
Insurance Premiums	16987.
Equipment Repair	10949.
Equipment Lease	0.
Cash Rent	0.
Interest:	
Operating Loan	3144.
Equipment and Livestock	0.
Land and Buildings	2250.
Other	0.
Property Taxes	3947.
Misc. Crop Expenses	1575.
TOTAL CASH EXPENSES	93745.
NET CASH FARM INCOME	50290.
+ Ending crop inventories	0.
+ Change in value of crops in ground	0.
- Economic depreciation	
Equipment	18438.
Long term assets	356.
NET FARM INCOME	31497.
- All federal taxes	4556.
- All government pension	1182.
- State corporate income tax	2094.
NET INCOME AFTER TAXES (NIAT)	23665.
+ Land capital gains	0.
NIAT AND CAPITAL GAINS	23665.
- Net family withdrawals	24612.
+ Change in nonfarm net worth	0.
CHANGE IN TOTAL NET WORTH	-947.

The disadvantage of a simulation approach is the difficulty in providing decisionmaking ability as part of the modelling process. For example, if the barley price is expected to be low over the next few years, the farmer may opt to plant fewer acres of barley. To model this behavior in a simulation model would require a set of rules that determine when to shift away from barley acreage, how much to move into other crops, and identification of what other crops should be planted. Because many thousands of similar decisions are available to a farm operator, the use of decision making rules in this simulation model was generally avoided. A method of reducing the number of decision rules, while maintaining a realistic analysis of a farm situation, is to shorten the simulation period. In this study, therefore, the analytical focus is on the 1991 tax year.

Data and Assumptions

A detailed presentation of the data used in the base scenario for the United States and Australian models are given in the Appendix. The U.S. farm is so similar to its Canadian counterpart that the Canadian data set was not included. Major differences between the data sets for Canada and the U.S. are given in the first seven tables or included in the discussion in this and previous sections. Assumptions specific to a set of analyses are discussed in the Results and Analysis section of the report.

Farmers in both Canada and the United States were assumed to participate in government programs, including the purchase of crop insurance. U.S. target prices and loan rates were consistent with values defined in the 1991 Farm Bill. Set-aside rates of 7.5 percent for barley and 15 percent for wheat reflected 1991 farm program provisions. The 1991 target prices for Canada's GRIP program were based on actual values. The insurance premium for GRIP was 6.0 percent for barley, 7.5 percent for spring wheat, and 9.5 percent for durum wheat.

The farmer was assumed to be married, with two children (ages 16 and 8). Living expenses were treated as normal, long-run expenditures that do not respond to year-to-year fluctuations in income. The exception to this assumption was for charitable expenditures, which represented 2.5 percent of taxable farm income. The 2.5 percent figure is consistent with U.S. Internal Revenue Service averages for itemized charitable contributions (Prentice-Hall, Inc.). Tuition deductions in Canada were assumed zero.

Equipment complements for each farm situation were identified based on actual farming operations in the study areas, supplemented by expert advice of extension agents and specialists. No equipment was replaced in 1991. Functions provided in the *Agricultural Engineers Yearbook* were used to calculate repair costs. Depreciation estimates reflected actual change in market value each year and were made using functions estimated by Cross.

Prices and yields were assumed the major sources of uncertainty and were treated as random variables. Both sets of random variables were assumed to exhibit multivariate, normal distributions. Data for the yield distributions were based on actual farm level yield information. A special effort was made to ensure the price data from each country reflected the same time period (1981-90) and (when possible) the same marketing year. Australian and

Canadian prices were converted to their U.S. dollar equivalent using the exchange rate in effect each year.

Means and standard deviations for Canadian wheat prices were calculated using the CWB wheat prices for 1981-90 time period. Barley prices were calculated using prices registered in the Lethbridge, Alberta feed market. Because the CWB market year (August-July) does not coincide with that used in USDA calculations (June-May), monthly average prices for wheat and barley at Portland, Oregon were averaged for August through July. Australian price was based on the Australian Wheat Board price for the 1981-90 period.

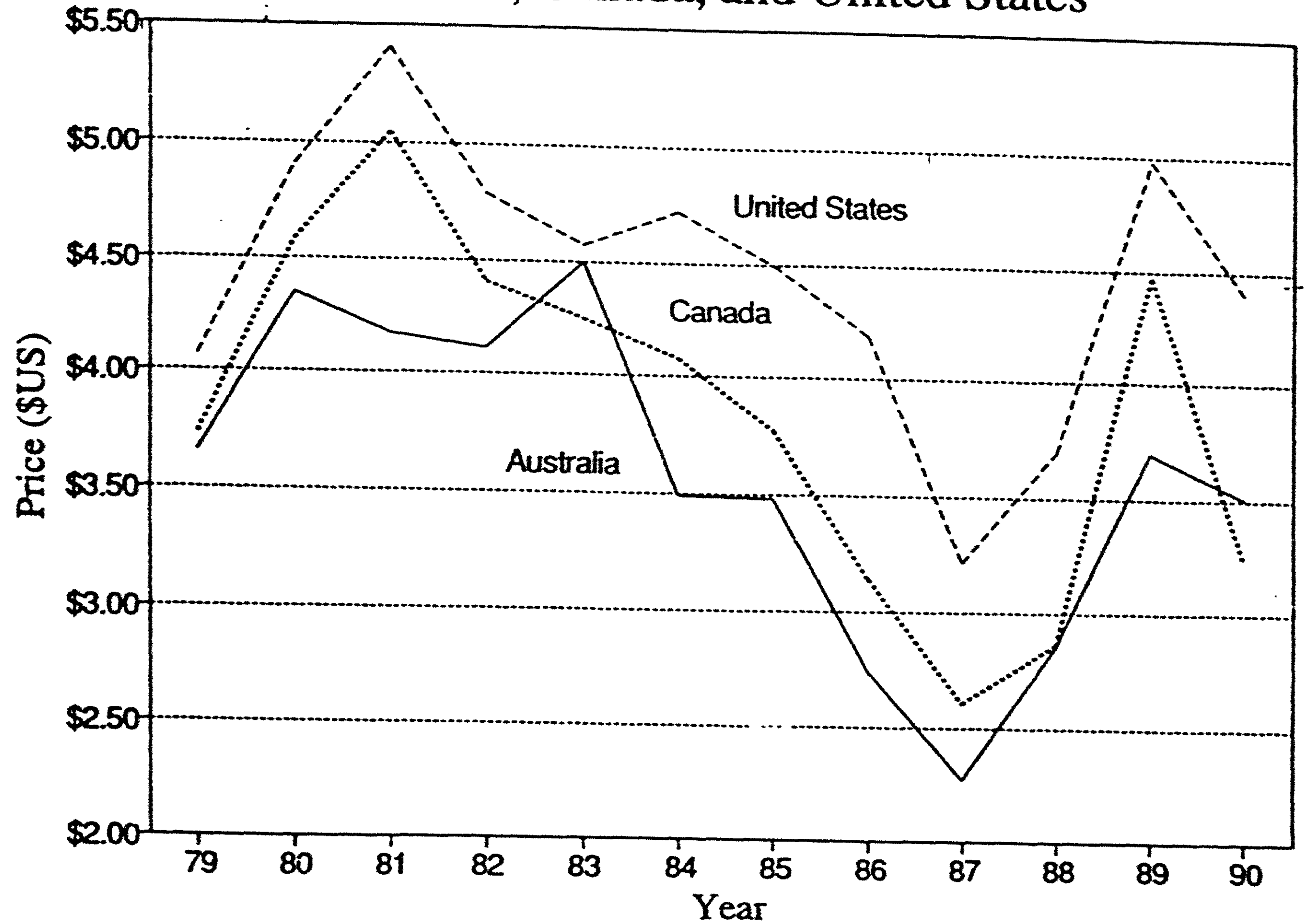
As Figure 2 demonstrates, the Portland price was consistently higher than its Canadian or Australian counterpart. The lower Australian price can be attributed to differences in transportation costs. The difference between U.S. and Canadian prices, however, is larger than the transportation difference between Vancouver and Portland. The CWB price is a pool price for wheat shipped out of Vancouver, B.C. and Thunder Bay, Ontario. One would expect the Thunder Bay price to be considerably lower than that in Vancouver, because of the additional transportation costs from Thunder Bay to the Atlantic Ocean. Consequently, pooling has the effect of subsidizing farmers who ship their grain to Thunder Bay at the expense of those shipping to Vancouver.

Section 179 expensing of $10,000 was elected by the U.S. farm operator. A MACRS depreciation schedule was used for calculating depreciation in the United States, with declining balance methods used in Canada and Australia. Participation in Canada's RRSP program and Australia's Income Stabilisation Program was based on a breakpoint income level. The assumption was that if taxable income was above this breakpoint income, the farmer would put money in these funds (subject to the rules of each program); if below the breakpoint income, withdrawals would be made. The breakpoint income levels varied from scenario to scenario, but were set so that the expected ending fund balance would be within $100 of the beginning balance.

Typical grain farms in all three counties contain about 2,000 acres of cropland. In the United States and Canada, half of the acreage is in fallow during any given year. In Australia the land is usually in continuous production. The representative farm size for both Canada and the United States was 2,100 acres, of which 640 acres were currently being purchased. The purchased acreage was financed through Farm Credit Services (FCS) in the United States and the AFCSP in Canada. The Australian farm was 2,000 acres, all of which was being purchased by the farmer. The Australian farm had a much smaller debt load, consistent with the actual farm debt situation in that country. The farmer was assumed to begin the 1991 year with $10,000 in cash. In the United States this cash was available to pay operating expenses. In Canada, this cash was invested in the RRSP, with the cash invested in the Income Stabilization Program for the Australian scenarios. The farmer's wife was assumed to help on the farm and also generated $200/month in off-farm income.

Unless otherwise indicated, the analyses are based on the presumption that the farm business was organized as a husband-wife partnership in Australia and Canada and a sole proprietorship in the United States. In the husband-wife scenarios, the husband receives 60

Figure 2. Wheat Price Series for Australia, Canada, and United States



percent of the farm income. The wife receives the remaining 40 percent, all off-farm income (including child support payments) and claims the children as dependents for tax purposes.

Base Scenario Results and Analysis

The base scenario consists of nine different simulation situations. The first three situations are given in Table 8. Working backwards, situation three is an analysis of the Montana farm as described, being subject to United States, Montana, and Toole County taxes and receiving U.S. social program benefits[7]. The second situation uses the same Montana farm, but subjects it to taxation under the Canadian system and allows the farm family to receive Canadian social program benefits. It is as if the international border were moved south and the Montana farm became subject to taxes and qualified for social program benefits in Warner County, Alberta, but participated in the U.S. government farm program, purchased farm production inputs, and procured family support items in Montana. The first situation is identical to the second, except that Australian tax and social programs are substituted for their Canadian counterparts.

Situations four through six and seven through nine follow this same pattern, except the base farms are located in Alberta and New South Wales. This approach allows the taxation benefits (and costs) to be separated from the farm program benefits for each country. By comparing the situations in Table 8, for example, one can obtain an estimate of comparative advantage between New South Wales, Alberta, and Montana for tax policy and social programs.

In the base analysis of the Montana farm (Table 8), both crop receipts and government payments remained the same under all three scenarios. But other farm income varied somewhat because of differences in interest income. Cash farm expenses were higher in the U.S. scenario because of worker's compensation insurance. Canadian and Australian cash receipts were lower and interest expenses higher because the U.S. farm had $10,000 cash available for operating expenses, thereby reducing operating loan needs and increasing savings interest. The net effect was an approximate $1,500 income advantage for the Canadian and Australian scenarios vs. the U.S. scenario.

Total tax payments were highest in the U.S., with $9,040 in expected federal, state, and local taxes. Canadian taxes were approximately $1,300 lower, with Australian taxes some $2,700 lower. The single biggest tax disadvantage for the U.S. farm was pension and medicare payments. Sales and fuel taxes in Australia were higher than the other two countries. Family withdrawals were substantially lower in Australia and Canada because of the family allowance payments and lower health care costs. The "bottom line" measure of tax and social program differences was the change in net worth. A comparison of these measures

[7]To make the subsequent discussion easier to follow, the federal, state, and local taxes and social programs for the Toole County, Montana farm will be referred to as "U.S. taxes", with "Canadian taxes" being used to refer to the same set of tax and social programs for Warner County, Alberta and "Australian taxes" referring to the tax and social programs in Moree District, New South Wales.

Table 8. Comparison of 2,100 Acre Montana Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Situation Number	1	2	3
Crop Receipts	72,185	72,185	72,185
Government Payments	10,377	10,377	10,377
Other Farm Income	2,219	2,201	2,443
Total Cash Receipts	84,781	84,763	85,005
Cash Farm Expenses	48,683	48,730	50,426
Net Cash Farm Income	36,098	36,033	34,579
Fixed Costs	11,316	11,316	11,316
Net Farm Income	24,782	24,717	23,263
Tax Payments			
Federal	3,180	1,860	1,866
State	0	1,243	1,086
Sales\Fuel	2,055	1,946	324
Pension\Medicare	148	1,995	3,467
Property	912	1,700	2,297
Total	6,295	7,744	9,040
Net Family Withdrawals	16,096	16,942	19,416
Change in Net Worth	2,391	31	-5,193

suggests the Australian tax and social programs provide a $7,584 advantage over the U.S. farm. Stated in percentage terms, this additional profit was approximately equivalent to a 20 percent increase in net cash farm income for the U.S. farm. The Australian tax and social programs also had a $2,360 advantage over the Canadian tax policies. The Canadian tax and social programs, in turn, dominated the U.S. tax programs by $5,223, or 15 percent of net cash farm income.

Although on the surface the comparison presented here seems appropriate, a few caveats are needed. First, fixed costs reported in Table 8 are largely economic depreciation of farm equipment and buildings. Although they are equal in all three scenarios, differences in government tax policy between countries mean that tax depreciation is not the same. Depreciation is lowest ($3,834) under U.S. taxes because of the accelerated nature of U.S. depreciation schedules. Canadian tax depreciation is somewhat higher ($4,915) and depreciation under the Australian tax code is substantially higher ($9,010). Consequently, one reason why Australian and Canadian taxes are lower than they are in the United States is because taxable income is lower in those two countries.

A second point is the treatment of the tax-deferred funds in the model. As was noted previously, deposits and withdrawals were based on a breakpoint income level, with the goal of keeping ending expected fund balances at the same level as the beginning balances. Not included in these calculations, however, was the interest earned on the fund itself. If this additional income were added as other farm income to the income statement and tax depreciation allowances were lowered to United States levels, the change in net worth for Australian taxes would fall by about $600 (to $1,779) and that for Canada would rise by $450 dollars (to $494). Consequently, these adjustments do not change the relative ranking between countries.

Table 9 contains a summary of the results for the Alberta farm, under Australian, Canadian, and U.S. tax policies and social programs. The rankings among the different tax and social programs was similar to that exhibited in Table 8.

The similarity in size and productive potential of the Alberta and Montana farms permits a comparison of government farm program and production cost advantages that may exist in each country. This type of comparison is appropriate only if tax policy is the same for both farms. For example, comparing the Montana and Alberta farms under Canadian tax policy suggests the Montana farm generates a change in net worth that is $3,898 above that for the Alberta farm. Similar results are obtained when comparing the two farms under U.S. or Australian tax policy. This comparison suggests: (1) For this farming situation, U.S. farm programs and cost of production advantages provide a return that is about $3,800 (or about 11 percent of net cash farm income) higher than that for the Canadian farm programs and costs of production, and (2) tax and social programs provide an competitive advantage in trade of about $5,200 (or about 15 percent) in Canada. From this comparison it can be concluded that, for this particular farm, taxes and social programs play a greater role than government farm programs and costs of production in determining competitive advantage in trade.

Table 10 highlights results comparing tax policy between the three countries for the representative New South Wales farm. This farm was much more profitable than its Alberta

Table 9. Comparison of 2,100 Acre Alberta Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	72,162	72,162	72,162
Government Payments	11,337	11,337	11,337
Other Farm Income	1,893	1,887	2,097
Total Cash Receipts	85,392	85,386	85,596
Cash Farm Expenses	53,314	53,371	54,894
Net Cash Farm Income	32,078	32,015	30,702
Fixed Costs	12,069	12,069	12,069
Net Farm Income	20,009	19,946	18,633
Tax Payments			
Federal	2,163	884	1,053
State	0	749	730
Sales\Fuel	2,024	1,892	312
Pension\Medicare	28	860	3,037
Property	912	1,700	2,351
Total	5,127	6,085	7,483
Net Family Withdrawals	16,860	17,728	20,064
Change in Net Worth	-1,978	-3,867	-8,914

Table 10. Comparison of 2,000 Acre New South Wales Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	206,891	206,891	206,891
Government Payments	0	0	0
Other Farm Income	12,267	11,903	12,498
Total Cash Receipts	219,158	218,794	219,389
Cash Farm Expenses	95,359	95,694	98,996
Net Cash Farm Income	123,799	123,100	120,393
Fixed Costs	19,751	19,751	19,751
Net Farm Income	104,048	103,349	100,642
Tax Payments			
Federal	33,949	21,861	22,114
State	0	11,125	9,630
Sales/Fuel	4,164	5,471	688
Pension/Medicare	1,208	1,879	7,456
Property	1,873	3,947	4,638
Total	41,194	44,283	44,526
Net Family Withdrawals	31,904	31,157	34,952
Change in Net Worth	30,950	27,909	21,164

and Montana counterpart, resulting in much higher profits and tax payments. Living expenses and sales tax levels reported in Table 11 were used in this analysis. Australian tax and social program advantages remained substantially above those for Canada which, in turn, remained above those for the United States. In percentage terms, however, the advantages provided in Australia and Canada over the United States were less than half that generated for the Montana farm. When differences in tax depreciation and interest on tax-deferred funds were included, the advantage under Australian vs. U.S. taxes was reduced to $5,318 and the advantage for Canada vs. the United States shrunk to $2,696. This set of scenarios suggests Australian and Canadian tax policies tend to provide their greatest advantages over U.S. tax policies at low income levels, largely because their tax exemptions and social programs are more generous at this level. The difference between Australian and Canadian tax and social program policies remains roughly the same across all three farms.

Sensitivity Analyses

The results presented in Tables 8-10 are for three typical farms. As such, care is required in making general statements about competitive advantage between the United States, Australia, and Canada. As these base analyses already suggest, differences in farm size could cause the results to differ. Numerous other variables could cause the results to differ, including business organization, debt level, and family size. The following analyses were created to address these concerns.

Alternative Farm Sizes

Two additional farms were created for Montana and Alberta to further investigate the influence of farm size on the base results. The first farm created for both countries contained 960 acres of land and is designated as the "small" farm for discussion purposes. The large farm contained 4,200 acres of farmland.

•Small Farm

In the small farm scenario one spouse was assumed employed full-time off the farm, generating a gross income of $24,000/year. The farmer remained employed full-time on the farm. A grain-fallow rotation was again followed, with roughly the same crop mix as that given in Table 2. Of the 960 acre farm, the farmer was purchasing 640 acres and renting the remainder. The farmer began the year with $5,000 in cash, either available as operating capital or invested in a tax-deferred fund similar to the base scenario. Living expenses are unchanged from the base analyses. In summary, farm income was less important to this farm family and family income was also much more stable[8].

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[8]Net family withdrawals were negative in this scenario because family living expenses were less than the combination of off-farm income and family allowance payments. In essence, the off-farm income was being used to offset some of family's income tax obligations.

Table 11. Monthly Living Expenses by Item for US Farm and Corresponding Expenditures in Canada and Australia—Large Farm Scenario

	United States		Canada		Australia	
	Cost	Tax	Cost	Tax	Cost	Tax
Housing	0	.00	0	.00	0	.00
Food	400	.00	470	3.30	485	5.00
Utilities	150	.00	153	10.71	93	.00
Family Vehicles						
Payment	723	11.00	753	52.00	762	102.00
Insurance	75	.00	65	.00	60	.00
Fuel	105	40.28	100	150.00	120	175.00
Clothing	225	.00	225	15.75	249	.00
Furniture	225	.00	225	15.75	233	15.00
Entertainment	200	.00	200	14.00	220	.00
Medical						
Insurance	200	.00	63	0.00	38	.00
Out-of-Pocket Costs	40	.00	40	0.00	40	.00
Miscellaneous	200	.00	200	14.00	450	45.00
Total	$2,543	$51.28	$2,494	$275.51	$2,750	$347.00

In this scenario (Table 12) the U.S. farmer had a significantly lower tax burden than the Canadian or Australian farmer. Family allowance payments, lower medical costs and no worker's compensation insurance all contributed to favor Australia and Canada by almost $4,000[9], or 25 percent of net cash farm income. Most of the tax benefit for the U.S. farm (relative to previous analyses) was the result of full-time employment of the spouse off the farm, resulting in the employer paying half of the social security tax. Consequently, taxable income was roughly the same as it was under the 2,100 acre farm scenario, but the family's social security taxes were much lower. If these additional pension and medicare taxes were added to both Canadian and U.S. tax scenarios, total U.S. taxes would be approximately $1,100 higher than in Australia and $600 higher than in Canada.

Table 13 contains results for the 960 acre Alberta farm under different tax and social programs. The tax results again reflected those exhibited for the Montana farm. Comparison of farm programs and costs of production (Tables 12 and 13) suggests the Montana farm had an approximate $1,900 change in net worth advantage. As in the base scenario, the Canadian tax and social program advantages outweighed U.S. farm programs and cost of production advantages.

•Large Farm Size

Two large farms were next analyzed for Montana and Alberta. Each farm contained 4,200 acres of tillable land, of which 2,520 was being purchased by the farmer and the remainder was rented under a crop-share arrangement. The wife had no outside employment. Living expenses used are given in Table 11. The crop mix was consistent with that used for the other Alberta and Montana farms.

Results of this large farm analysis for the Montana farm are given in Table 14. The patterns exhibited in the results were consistent with those seen earlier in the New South Wales farm scenario (Table 10). Australia's change in net worth was again highest, followed by Canada and the United States. Adjusting for differences in tax depreciation and tax-deferred interest had little impact on these results. The results in Table 15 also exhibit similar results for the Alberta farm. Differences in government farm programs and costs of production (comparing Tables 14 and 15) suggest a $10,000 advantage favoring the Montana farm. This difference is greater than the tax advantage between the United States and Canada, suggesting government farm programs and costs of production are more important in determining competitive advantage than tax and social programs for larger farming operations.

Alternative Business Organizations

In the base scenarios it was assumed that farmers operating under Canadian and Australian tax law would prefer to be organized as a husband-wife partnership, whereas a sole

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[9]Tax depreciation was nearly identical under both U.S. and Canadian tax law and was approximately $3,000 higher under Australian tax law. Because these differences (and interest earned on tax-deferred funds) were small, no adjustments were estimated for change in net worth.

Table 12. Comparison of 960 Acre Montana Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	33,672	33,672	33,672
Government Payments	4,920	4,920	4,920
Other Farm Income	1,165	1,167	1,302
Total Cash Receipts	39,757	39,759	39,894
Cash Farm Expenses	22,984	22,971	25,080
Net Cash Farm Income	16,773	16,788	14,814
Fixed Costs	6,764	6,764	6,764
Net Farm Income	10,009	10,024	8,050
Tax Payments			
Federal	5,714	2,985	2,248
State	0	1,820	1,166
Sales\Fuel	2,055	1,946	324
Pension\Medicare	284	933	2,808
Property	497	850	1,334
Total	8,550	8,534	7,880
Net Family Withdrawals	-4,867	-4,685	-2,184
Change in Net Worth	6,326	6,148	2,354

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Table 13. Comparison of 960 Acre Alberta Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	33,836	33,836	33,836
Government Payments	4,985	4,985	4,985
Other Farm Income	862	873	1,007
Total Cash Receipts	39,683	39,694	39,828
Cash Farm Expenses	24,525	24,450	26,530
Net Cash Farm Income	15,158	15,244	13,298
Fixed Costs	7,002	7,002	7,002
Net Farm Income	8,156	8,242	6,296
Tax Payments			
Federal	5,279	2,657	2,075
State	0	1,709	1,020
Sales\Fuel	2,024	1,892	300
Pension\Medicare	284	832	2,522
Property	497	850	1,343
Total	8,084	7,940	7,260
Net Family Withdrawals	-4,102	-3,872	-1,524
Change in Net Worth	4,174	4,174	560

Table 14. Comparison of 4,200 Acre Montana Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	163,066	163,066	163,066
Government Payments	21,379	21,379	21,379
Other Farm Income	4,802	4,796	5,053
Total Cash Receipts	189,247	189,241	189,498
Cash Farm Expenses	94,252	94,209	92,687
Net Cash Farm Income	94,995	95,032	92,684
Fixed Costs	18,175	18,175	18,175
Net Farm Income	76,820	76,857	74,512
Tax Payments			
Federal	20,269	12,705	11,456
State	0	6,402	5,231
Sales\Fuel	3,516	3,515	612
Pension\Medicare	867	2,056	7,354
Property	3,255	6,224	7,000
Total	27,907	30,902	31,653
Net Family Withdrawals	26,828	27,899	30,516
Change in Net Worth	22,085	18,056	12,343

Table 15. Comparison of 4,200 Acre Alberta Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	163,277	163,277	163,277
Government Payments	22,674	22,674	22,674
Other Farm Income	3,883	3,873	4,124
Total Cash Receipts	189,834	189,824	190,075
Cash Farm Expenses	109,230	109,214	111,619
Net Cash Farm Income	80,604	80,610	78,456
Fixed Costs	18,192	18,192	18,192
Net Farm Income	61,912	62,418	60,264
Tax Payments			
Federal	14,110	8,729	7,975
State	0	4,445	3,730
Sales\Fuel	3,492	3,306	588
Pension\Medicare	682	1,982	6,714
Property	3,255	6,224	7,032
Total	21,539	24,686	26,039
Net Family Withdrawals	27,854	29,106	30,732
Change in Net Worth	12,519	8,126	2,993

proprietorship was the preference in the United States. The analysis reported in Table 16 was conducted to verify that these organizational forms were indeed more profitable from a tax standpoint.

The results support the organizational assumptions made in the base scenario. Using a sole proprietorship in Australia cost the farmer approximately $2,300 in additional taxes. In Canada, a sole proprietorship was less costly, increasing the farmer's tax burden by about $1,500. In the United States, a husband-wife partnership only increased taxes by $400. This last result can be attributed to Montana state taxes, which are structured like the income tax systems in Australia and Canada and discriminate against single income families. The loss of earned income credit was largely responsible for the higher U.S. federal tax obligation.

•Corporate Farms

The effect of incorporation was next considered for the 2,100 and 4,200 acre Montana farms. Corporations are treated as a separate entity for taxation purposes, making a comparison between corporations and other business forms potentially misleading. In the base scenario it was assumed that the farmer was making withdrawals from the business to cover family living expenses and taxes, with remaining profits reinvested in the business. To assure a fair comparison between corporate and noncorporate organizations, it was assumed the farmer was paid a salary by the corporation equivalent to the withdrawals he was making from the farm when a sole proprietor. That is, the salary was equal to net family withdrawals plus federal and state taxes paid by the business for this salary. No other payments were made by the corporation to the farmer. Farm corporations are in fact often structured in this manner, with the corporation paying the farmer a salary to avoid double taxation on dividends. Even in Australia, where some attempt is made to minimize double taxation, a farmer is better off to have the corporation pay him (and his wife) a salary, rather than receiving all income in the form of corporate dividends. In line with the base scenario assumptions, both husband and wife received a salary from the corporation for Australia and Canada, with only the farmer receiving a salary in the United States.

Additional assumptions were needed to deal with income stabilisation programs in Canada and Australia. The income stabilisation fund in Australia, for example, receives contributions or accepts withdrawals only from individuals, not corporations. To assure a stable income for living expenses and tax obligations it was assumed the corporation changed the salary paid to the farmer so as to match the deposits or withdrawals into tax-exempt funds. For example, in an unprofitable year it may be determined that the farmer should withdraw $5,000 from his tax-exempt fund. The corporation would reduce the farmer's salary by $5,000 and the fund would be depleted by the same amount.

The results for the 2100 acre Montana farm are reported in Table 17. Incorporation was clearly profitable under the U.S. tax system, reducing the total tax burden by about $1,700 (or 18 percent of the base scenario tax burden). Over half of this tax savings was in the form of reduced social security taxes, the result of corporate profits being exempt from this tax. The Canadian farm also realized a reduction in taxes. Taxes under the Australian system went up by about 20 percent, a result of the 39 percent tax rate on corporate profits.

Table 16. Comparison of Alternative Organization Structures for 2,100 Acre Montana Farm

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Organization Type	Sole Proprietor	Sole Proprietor	Husband-Wive Partnership
Crop Receipts	72,185	72,185	72,185
Government Payments	10,377	10,377	10,377
Other Farm Income	2,202	2,185	2,439
Total Cash Receipts	84,764	84,747	85,001
Cash Farm Expense	48,745	48,830	50,435
Net Cash Farm Income	36,019	35,917	34,566
Fixed Costs	11,316	11,316	11,316
Net Farm Income	24,703	24,601	23,250
Tax Payments			
Federal	5,368	2,949	2,443
State	0	1,869	828
Sales	2,055	1,946	324
Government Pension	251	751	3,553
Property	912	1,700	2,297
Total	8,586	9,215	9,445
Net Family Withdrawals	16,096	16,942	19,416
Change in Net Worth	21	-1,556	-5,611

Table 17. Comparison of 2,100 Acre Montana Corporate Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	72,185	72,185	72,185
Government Payments	10,377	10,377	10,377
Other Farm Income	2,202	2,501	2,447
Total Cash Receipts	84,764	85,063	85,009
Cash Farm Income	48,748	48,003	50,415
Net Cash Farm Income	36,016	37,060	34,594
Fixed Costs	11,316	11,316	11,316
Net Farm Income	24,700	25,743	23,277
Tax Payments			
Federal Individual	1,929	-223	-55
Federal Corporate	2,665	1,648	1,505
State Individual	0	147	312
State Corporate	0	770	598
Sales\Fuel	2,055	1,946	324
Pension\Medicare	0	706	2,396
Property	912	1,700	2,297
Total	7,561	6,694	7,377
Net Family Withdrawals	16,096	16,942	19,416
Change in Net Worth	1,043	2,107	-3,516

The benefits of incorporation were even more dramatic for the 4,200 acre Montana farm (Table 18). In this case, however, it was the Canadian tax system that provided the greatest tax savings, with a total tax burden that was some $7,800 (or 25 percent) lower than occurred for the same farm under a husband-wife partnership. The large tax savings in Canada can be attributed to the much lower federal and provincial corporate tax rates.

Tax savings were also large under the U.S. tax system, with a reduction in tax of about $7,300 (or 23 percent). These tax reductions were again the result of much lower social security taxes. Also important was the lower average personal and federal tax rates, caused by splitting income between the corporation and the individual. Australian taxes were also lower under incorporation, an initially surprising result given the high corporate tax rate. In this case, however, personal income and medicare taxes were substantially lower, reducing the overall average marginal tax rate.

Differences in State and Local Taxes

State/provincial and local taxes both represent a substantial portion of the tax burden for farmers in both Canada and the United States. Yet, the state/provincial tax laws vary greatly in different parts of both countries. In order to determine the impact of varying state/provincial tax laws on the results, the Montana and Alberta farms were analyzed assuming they were located (for tax purposes) in North Dakota and Saskatchewan.

North Dakota imposes a five percent sales tax on nonfood items, an income tax similar to that of Montana, and a property tax on land and homes that is higher than that of Montana. Saskatchewan levies an income tax equal to 50 percent of federal tax plus two percent of taxable income, a sales tax on the same items taxed under the GST, and a relatively small property tax on land.

On the social programs side, Saskatchewan provides a comprehensive health care program at no cost to its citizens, provides family allowance payments that are somewhat lower than those received in Alberta, and provides tax credits to low income families to offset sales tax and child support expenses. North Dakota, on the other hand, does not require that farmers purchase worker's compensation insurance.

Table 19 contains a summary of the comparison between North Dakota and Saskatchewan. The tax burden was some $500 higher in North Dakota than Montana and about $850 higher in Saskatchewan than Alberta. Not having to purchase worker's compensation insurance left the North Dakota farmer better off than the Montana farmer. By not buying insurance, however, the North Dakota farmer is open to potentially serious financial consequences should the farmer or an employee be injured.

Although the Saskatchewan farmer paid much higher taxes than his Alberta counterpart, he also saved about $750 in health insurance costs. As a result, the change in net worth was only about $200 lower in Saskatchewan than Alberta. Overall, changes in net worth under the Canadian system remained higher than in the United States, with Australia remaining substantially higher than both.

Table 18. Comparison of 4,200 Acre Montana Corporate Farm Under Alternative Tax Policies and Social Programs

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	163,066	163,066	163,066
Government Payments	21,379	21,379	21,379
Other Farm Income	4,739	4,848	5,139
Total Cash Receipts	189,184	189,316	189,584
Cash Farm Expenses	94,470	93,976	96,600
Net Cash Farm Income	94,714	95,340	92,984
Fixed Costs	18,175	18,175	18,175
Net Farm Income	76,539	77,165	74,809
Tax Payments			
Federal Individual	6,846	5,310	7,534
Federal Corporate	15,425	2,630	1,938
State Individual	0	2,481	2,182
State Corporate	0	1,610	910
Sales\Fuel	3,516	3,515	612
Pension\Medicare	439	1,296	4,166
Property	3,255	6,224	7,000
Total	29,481	23,066	24,342
Net Family Withdrawals	26,828	27,889	30,516
Change in Net Worth	20,230	26,210	19,951

Table 19. Comparison of 2,100 Acre Montana and Alberta Farms Under North Dakota and Saskatchewan Tax Policies and Social Programs

	Montana Farm		Alberta Farm	
	North Dakota Taxes	Saskatchewan Taxes	North Dakota Taxes	Saskatchewan Taxes
Crop Receipts	72,185	72,185	72,167	72,162
Gov't Payments	10,377	10,377	11,377	11,337
Other Farm Income	2,467	2,208	2,065	1,885
Total Cash Receipts	85,029	84,770	85,609	85,384
Cash Farm Expenses	48,073	48,721	52,450	53,408
Net Cash Farm Income	36,956	36,049	33,159	31,976
Fixed Costs	11,316	11,316	12,069	12,069
Net Farm Income	25,640	24,733	21,090	19,907
Tax Payments				
Federal	2,218	1,798	1,422	894
State	791	1,590	538	1,048
Sales\Fuel	876	3,010	865	2,983
Pension\Medicare	3,796	1,002	3,404	865
Property	1,864	1,189	1,864	1,189
Total	9,545	8,589	8,093	6,979
Net Family Withdrawals	**19,416**	**16,326**	**20,195**	**17,109**
Change in Net Worth	**-3,321**	**-182**	**-7,198**	**-4,181**

Value of Children's Benefits

A number of the tax exemptions and social program benefits in all three countries are geared toward children. Family size, therefore, might be expected to make some difference on the results reported in the base scenario. To better understand this issue, a scenario was developed in which the number of children was increased to four (ages 16, 8, 6, and 4). Because the focus of the analysis was on understanding tax and social program benefits, the family living expenses were held constant for this scenario. An analysis was conducted for the 2,100 acre Montana farm.

The results, which are given in Table 20, suggest Canada provides the most lucrative package of tax exemptions and social programs for children. Increasing the family size by two increased change in net worth under Canadian taxes by about $2,100, or $1,050 per child. Australia's change in net worth increased by almost $1,000, the result of increased family allowance payments. The U.S. family's tax bill fell by about $650, mostly because of reduced federal income taxes.

No Farm Debt

Debt levels vary a great deal among different farms in the same area. In this analysis all farm debt was eliminated to examine what impact debt has on the base scenario results. The results of this analysis are in Table 21.

Profitability improved substantially as a result of debt elimination. Tax burdens also increased by large amounts, particularly for the Canadian tax scenario. The relative tax changes, however, were similar. Taxes increased the most under the Canadian system ($3,914) and the least under the Australian system ($3,117). Rankings between countries remained unchanged.

Social Programs and Retirement Benefits

One factor not considered in these analyses is the future value of retirement benefits. Farmers in the United States, for example, pay a hefty tax that is supposed to go toward their retirement. How large are these benefits compared with those provided in Australia and Canada? In this section a brief overview is provided of the different retirement programs, recognizing that a detailed comparison is well beyond the scope and focus of this study.

Under current provisions of the U.S. Social Security program, maximum benefits (of $1,462) are obtained if maximum self-employment taxes have been paid over the last five years.[10] In Canada, all residents age 65 and older receive $292/month in old age security benefits. In addition, they can receive $490/month from the Canada Pension Plan if their contributions over the last 10 years have been at the maximum ($25,925) level. In Australia

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[10]This presumes a single income household. If both spouses have maximum self-employment tax payments, the monthly maximum benefit is $1,950.

Table 20. Comparison of 2,100 Acre Montana Farm Assuming the Family Contains Four Children

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts	72,185	72,185	72,185
Government Payments	10,377	10,377	10,377
Other Farm Income	2,226	2,231	2,445
Total Cash Receipts	84,788	84,793	85,007
Cash Farm Expenses	48,659	48,623	50,420
Net Cash Farm Income	36,129	36,170	34,587
Fixed Costs	11,316	11,316	11,316
Net Farm Income	24,813	24,853	23,271
Tax Payments			
Federal	3,206	595	1,360
State	0	1,122	939
Sales\Fuel	2,055	1,946	324
Pension\Medicare	102	999	3,467
Property	912	1,700	2,297
Total	6,275	6,362	8,387
Net Family Withdrawals	15,165	16,337	19,416
Change in Net Worth	3,373	2,154	-4,532

Table 21. Comparison of 2,100 Acre Montana Farm Assuming No Debt for Farm Operator

1991 Expected Values	Australian Taxes	Canadian Taxes	U.S. Taxes
Crop Receipts Government Payments Other Farm Income	72,185 10,377 2,218	72,185 10,377 2,204	72,185 10,377 2,403
Total Cash Receipts	84,780	84,766	84,965
	37,590	37,645	39,386
Net Cash Farm Income	47,190	47,121	45,579
Fixed Costs	11,316	11,316	11,316
Net Farm Income	35,874	35,805	34,263
Tax Payments Federal State Sales/Fuel Pension/Medicare Property Total	 6,084 0 2,055 361 912 9,412	 4,231 2,362 1,946 1,419 1,700 11,658	 3,521 1,802 324 4,797 2,297 12,741
Net Family Withdrawals	16,096	16,942	19,416
Change in Net Worth	10,366	7,205	2,106

the pension for a married couple is $832/month. This pension amount is not influenced by the quantity of taxes paid in previous years. Retirement benefits in all three countries are reduced as taxable income increases.

For a husband and wife, maximum benefits from federal retirement programs would be $1,462/month in the United States, $1,565/month in Canada, and $832/month in Australia. In addition, health care is provided at minimal cost in Canada and Australia whereas those over 65 in the United States receive only partial support under Medicare.

Summary and Conclusions

The objective of this study was to estimate competitive advantage for case farms in Australia, Canada, and the United States. The particular focus of this analysis was on those factors influencing competitive advantage that have not normally been considered in trade negotiations, including tax policy and government social programs. A representative farm was developed for each country and the tax and social programs of each country were analyzed using these representative farms. Sensitivity analyses were conducted to provide greater insight into the results.

The results suggest that tax and social programs in Australia provide that country's farmers with a competitive advantage in trade, particularly for small and medium-sized farms. The only exception is large, incorporated farms, where U.S. and Canadian tax laws eliminate Australia's advantage. Canadian tax laws and social programs also generally provide competitive advantage to its farmers vis-à-vis the United States. Canadian tax and social program advantages are smallest for large nonincorporated farms, but the greater profitability of incorporated farms suggests this type of farming organization is probably rare in both countries.

Australia's tax laws definitely favor a husband-wife business organization. Corporations in Australia are only desirable from a tax standpoint if the farm is relatively large. Canadian tax law also favors a husband-wife partnership for small operations, but the corporate form is much more desirable for large farms. The corporate form is generally preferred in the United States, particularly for moderate and large scale businesses.

Australian and Canadian tax laws seem most favorably disposed toward self-employed individuals (such as farmers) and large businesses. The Australian tax burden falls much more heavily on moderate income salaried individuals than is the case for the United States and Canada. The U.S. tax law, on the other hand, seems to levy taxes relatively more heavily on the self-employed businessman than Canada and Australia. United States tax law also does not provide the tax breaks for low income persons that are available in the other two countries. Salaried workers seem to fare best in the United States than other countries. Differences in taxes exist between states and provinces, but these differences seem less important than the differences between countries.

There was a clear advantage to farm under U.S. government farm programs and costs of production versus those in Canada. This advantage was particularly apparent for large farming operations. The high costs imposed by the Canadian Wheat Board on the case farm

are largely responsible for the noncompetitiveness of Canadian production costs. In fact, these costs almost completely offset the competitive advantage provided by the Canadian farm programs. Caution must be exercised in generalizing this result, however,. Quite likely farmers in Saskatchewan and Manitoba receive a market price that is above the level they would receive if there was no marketing board.

Canada provides the best set of benefits for families with children. The United States provides the worst set of benefits. The relative rankings given in the base results did not change when farm debt was eliminated.

A number of assumptions have been made which are critical to the analysis. Cost of living estimates were tied to the farm, rather than the government tax and social program scheme. No doubt this is not completely correct because some living expenses are influenced by government policies (e.g., tariffs on imports). Further investigation is needed to determine what effect government policies have on living expenses.

An important assumption under both Australian and Canadian tax policy was managing the tax-exempt funds to maintain an approximately level expected fund balance. This assumption is particularly important for the Australian tax scenarios because the beginning fund balance was so low relative to the limits placed by government on total balance. The Australian farmer can save a great deal in taxes, for example, by allowing the fund to accumulate reserves over time. In addition, a larger fund reserve provides more flexibility in reducing taxes while maintaining a constant fund level.

Further work is needed to compare tax policy in these three countries with that in other major wheat exporting countries, particularly Argentina and the EC. For example, the competitive disadvantage suggested by the PSE in Table 1 for Argentina may not be nearly that large, because most Argentines do not pay any income taxes.

Other commodities should also be analyzed. Livestock enterprises, for example, are treated differently for tax purposes and so should be examined in a future study. Other types of cropping enterprises (such as vegetable production) may differ substantially in their mix of land, capital, and variable input use, generating substantially different results than those presented here.

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APPENDIX
DATA SETS FOR MONTANA AND NEW SOUTH WALES FARMS

1

THE FARM MANAGEMENT SIMULATION MODEL

DEVELOPED AT OREGON STATE UNIVERSITY

BY
GREGORY M. PERRY

VERSION 2.0, JUNE 1990

****

FAMSIM ANALYSIS FOR REPRESENTATIVE TOOLE COUNTY, MONTANA FARM.
BASED ON DATA OBTAINED FROM OF SHELBY, MONTANA.
FARM CONTAINS 2100 ACRES OF LAND, IN SPRING WHEAT,
BARLEY, AND SUMMER FALLOW, WITH A DURUM ACTIVITY THATS NOT ACTIVE

The simulation is for 1 years, with the first year being 1991
The simulation is stochastic, with 25 iterationsspecified
There are 5 crops included in the model
There are 9 regular variables in the model treated as stochastic. all others are assumed known with certainty;
Of these stochastic variables, 3 are correlated using one correlation matrix.
A second set of 4 variables are correlated usiing a second correlation matrix. The two matrices are assumed independent of one another.
There are 2 ASCS farm units within this operation.
There are 4 long-term lease in the model.
There are 21 pieces of equipment in the complement
Farm is located in the United States for tax purposes.
Section 179 deduction (expensing) is in effect.
Farm is a sole proprietorship for tax purposes
Proven yields are average of previous proven yields.
No attempt will be made to improve projected cash-flow statement if it does not meet criteria for operating loan.
The following information will be printed:
- All input data
- Only the final cash flow, income, and balance sheet statements
- Statistical information on all output variables

************************************GENERAL PRODUCTION INFORMATION************************************

ACREAGE BY ASCS OR OTHER SUBFARM UNIT

**********ASCS Farm Unit # 1
Name: HOME ACREAGE
Land Status: OWNED   Asset Number: 1.

ACREAGE

CROP NAME	1991
Spring Wheat	220.
Winter Wheat	0.
Fallow	320.
Barley	100.
Durum Wheat	0.

CROP NAME	OPTIONAL ACREAGE IDLEMENT PROGRAM #1	#2	PROGRAM PARTICIPATION BY YEAR 1991
Spring Wheat			YES
Winter Wheat			YES
Fallow			NO
Barley			YES
Durum Wheat			NO

**********ASCS Farm Unit # 2
Name: GRANDPA'S FARM
Land Status: RENTED   Asset Number: 0.

CROP NAME	RENTAL ARRANGEMENT	COST	ACREAGE 1991
Spring Wheat	SHARE	.00	480.
Winter Wheat	SHARE	.00	50.
Fallow	SHARE	.00	730.
Barley	SHARE	.00	200.
Durum Wheat	SHARE	.00	0.

CROP NAME	OPTIONAL ACREAGE IDLEMENT PROGRAM #1	#2	PROGRAM PARTICIPATION BY YEAR 1991
Spring Wheat			YES
Winter Wheat			YES
Fallow			NO
Barley			YES
Durum Wheat			NO

DIFFERENCE BETWEEN THE FOLLOWING INTEREST RATES
AND THE PRIME RATE

TYPE OF INTEREST	1991
Variable operating	.010

Variable savings	-.030
Variable int. term	.010
Fixed intermed. term	.000
Variable long term	.000
Fixed long term	.000
CCC loan	-.030

OFF-FARM INCOME AND MISCELLANEOUS EXPENSES

ITEM	January	February	March	April	May	June	July	August	September	October	November	December
Off-farm income	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.
Miscellaneous exp.	0.	0.	350.	300.	300.	300.	300.	300.	0.	0.	0.	0.

LABOR SUPPLY AND COST

	January	February	March	April	May	June	July	August	September	October	November	December
Family labor (free)	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.
Family labor (paid)	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Full-time hired help	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Family labor salary	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Hired salary per man	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.

Hourly labor receives $ 5.00 per hour
Farm employs 0. full-time laborers.
Fuel costs are $ .80/gallon.

********************************* MARKETING INFORMATION FOR CROPS *********************************

PROPORTION OF CROP SOLD EACH MONTH OF MARKETING YEAR

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.100	.150	.250	.500
Winter Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.100	.150	.250	.500
Fallow	.000	.000	.000	.000	.000	.000	.000	.000	1.000	.000	.000	.000
Barley	.000	.000	.000	.000	.000	.000	.000	.000	.100	.150	.250	.500
Durum Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.100	.150	.250	.500

MONTHLY PRICE INDICES FOR CROPS

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	1.000	1.010	1.020	1.000	1.000	1.000	1.000	1.000	.960	.970	.980	.990
Winter Wheat	1.000	1.010	1.020	1.000	1.000	1.000	1.000	1.000	.960	.970	.980	.990
Fallow	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Barley	1.000	1.010	1.020	1.000	1.000	1.000	1.000	1.000	.960	.970	.980	.990
Durum Wheat	1.000	1.010	1.020	1.000	1.000	1.000	1.000	1.000	.960	.970	.980	.990

MONTHLY PREMIUM INDICES FOR PIK CERTIFICATES

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Winter Wheat	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Fallow	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Barley	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Durum Wheat	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000

PROPORTION OF CROP HARVESTED BY MONTH

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Winter Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Fallow	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Barley	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Durum Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000

CROP	BEGINNING STOCKS	EXPECTED PRICE FOR STOCKS	FIRST MARKETING MONTH	LIVESTOCK FEED	STORABLE CROP
Spring Wheat	0.	.000	September	NO	YES
Winter Wheat	0.	.000	September	NO	YES
Fallow	0.	.000	August	NO	YES
Barley	0.	.000	August	NO	YES
Durum Wheat	0.	.000	August	NO	YES

********************************* EQUIPMENT AND FIELD OPERATIONS *********************************

BEGINNING EQUIPMENT COMPLEMENT

EQUIPMENT NAME	CODE NO.	PURCHASE PRICE	YEAR NEW	YEAR BOUGHT	INITIAL HOURS	MAXIMUM HOURS	PERCENT USAGE	REP. COST SCALAR	SALVAGE VALUE	DEPRECIATION PERIOD	AMOUNT DEPRECIATED	INSURANCE
32' Chiesel Plw	36.	7600.	1982.	1983.	2500.	300.	1.000	.10	250.	7.	7600.	.47
2 12' JD Drills	36.	10000.	1980.	1963.	2000.	300.	1.000	.15	1000.	7.	9000.	.47
Rodweeders	22.	1000.	1982.	1964.	5000.	300.	1.000	.50	0.	0.	1000.	.47
Rockpicker	70.	6200.	1990.	1990.	100.	300.	1.000	.00	0	0.	664.	.47
Pickup	60.	6000.	1984.	1984.	50000.	2000.	1.000	.50	0.	0.	6000.	5.00
2 1/2 T Truck	62.	4000.	1970.	1955.	50000.	2000.	.500	.50	400.	7.	3600.	.47
2 1/2 T Truck	62.	4000.	1981.	1956.	50000.	2000.	.500	.50	0.	0.	4000.	.47
2 12' Mel Drill	35.	12000.	1975.	1975.	1500.	350.	1.000	.15	1200.	7.	10800.	.47
20'Ver400 Swath	49.	6000.	1981.	1976.	1000.	300.	1.000	.50	0.	0.	6000.	.47
P/U Mount Spray	56.	500.	1978.	1975.	500.	300.	1.000	1.00	50.	7.	450.	.47
Harrow	28.	500.	1980.	1980.	800.	300.	1.000	1.00	50.	7.	450.	.47
20' Offset Disc	24.	2500.	1980.	1976.	1000.	400.	1.000	.50	0.	0.	1123.	.47
53 GMC 1.5T Trk	63.	2500.	1975.	1953.	10000.	200.	1.000	.50	250.	7.	2250.	.47
Fert Spreader	53.	3500.	1984.	1975.	250.	300.	1.000	1.00	0.	0.	3500.	.47
MM UTS Tractor	1.	1500.	1980.	1956.	7000.	400.	1.000	1.00	0.	0.	1500.	.47
4040 JD Tractor	2.	14000.	1987.	1970.	2500.	400.	1.000	1.00	0.	0.	7990.	.47
850 [illegible] Tractr	1.	1000.	1980.	1953.	7500.	400.	1.000	1.00	0.	0.	449.	.47
Misc [illegible]ipment	71.	8000.	1983.	1965.	6000.	300.	1.000	1.00	0.	0.	8000.	.47
Augers	68.	2000.	1984.	1975.	2000.	300.	1.000	.15	0.	0.	2000.	.47
Steiger Bear III	7.	65000.	1983.	1983.	3200.	400.	1.000	1.00	0.	0.	65000.	.47
JD 7700 Combine	39.	50000.	1978.	1978.	2600.	300.	1.000	1.00	800.	7.	49200.	.65

DEBT INFORMATION ON BEGINNING COMPLEMENT

NAME	FINANCING SOURCE	PAYMENT SCHEDULE	INTEREST RATE	RATE TYPE	PAYMENT	AMOUNT FINANCED	CURRENT PRINCIPAL	TOTAL PAYMENTS	PAYMENTS REMAINING	MONTH PAID
32' Chiesel Plw	Single	Annual	10.50	Fixed	.00	0.	0.	5.	0.	December
2 12' JD Drills	Group		.00		.00	0.	0.	0.	0.	
Rodweeders	Group		.00		.00	0.	0.	0.	0.	
Rockpicker	Single	Annual	10.50	Fixed	1041.98	3900.	3900.	5.	5.	December
Pickup	Single	Annual	10.50	Fixed	.00	0.	0.	5.	0.	December

2 1/2 T Truck	Group		.00		.00	0.	0.	0.	0.	
2 1/2 T Truck	Single	Annual	10.50	Fixed	.00	0.	0.	5.	0.	December
2 12' Mel Drill	Single	Annual	10.50	Fixed	.00	0.	0.	5.	0.	December
20'Ver400 Swath	Group		.00		.00	0.	0.	0.	0.	
P/U Mount Spray	Group		.00		.00	0.	0.	0.	0.	
Harrow	Group		.00		.00	0.	0.	0.	0.	
20' Offset Disc	Single	Annual	10.50	Fixed	347.33	1300.	599.	5.	2.	December
53 GMC 1.5T Trk	Group		.00		.00	0.	0.	0.	0.	
Fert Spreader	Group		.00		.00	0.	0.	0.	0.	
MM UTS Tractor	Group		.00		.00	0.	0.	0.	0.	
4040 JD Tractor	Single	Annual	10.50	Fixed	764.12	2860.	1317.	5.	2.	December
850 Ford Tractr	Group		.00		.00	0.	0.	0.	0.	
Misc Equipment	Group		.00		.00	0.	0.	0.	0.	
Augers	Group		.00		.00	0.	0.	0.	0.	
Steiger Bar III	Single	Annual	10.50	Fixed	.00	0.	0.	5.	0.	January
JD 7700 Combine	Single	Annual	10.50	Fixed	.00	0.	0.	5.	0.	January

OTHER BEGINNING INTERMEDIATE DEBT COMMITTMENTS TOTALS 0.

GROUP INTERMEDIATE DEBT INFORMATION IS AS FOLLOWS:
Beginning Principal 0.
Time Period Remaining 5. Years
Interest Rate 10.5 Percent
Rate Type Fixed
Month Paid December

Insurance premiums for farm assets are paid in April

REPLACEMENT INFORMATION FOR EQUIPMENT

EQUIPMENT NAME	HOURS AT TRADEIN	MAXIMUM HOURS	REPLACEMENT COST	AGE WHEN PURCHASED	HOURS WHEN PURCHASED	LEASE COST ($/MONTH)	FINANCING SOURCE	TYPE OF RATE	PAYMENT SCHEDULE
32' Chiesel Plw	6300.	6300.	20000.	0.	0.	1500.	Private	Fixed	Annual
2 12' JD Drills	2800.	2800.	14000.	3.	400.	2000.	Group	Variable	Annual
Rodweeders	13000.	13000.	10000.	0.	0.	1000.	Group	Variable	Annual
Rockpicker	9000.	9000.	6000.	0.	0.	800.	Group	Variable	Annual
Pickup	100000.	100000.	12000.	0.	0.	300.	Private	Fixed	Annual
2 1/2 T Truck	200000.	200000.	25000.	0.	0.	800.	Group	Variable	Annual
2 1/2 T Truck	200000.	200000.	35000.	0.	0.	800.	Private	Fixed	Annual
2 12' Mel Drill	2900.	3200.	14000.	3.	400.	2000.	Group	Variable	Annual
20'Ver400 Swath	2500.	2500.	10000.	4.	500.	1800.	Group	Variable	Annual
P/U Mount Spray	9000.	9000.	1000.	0.	0.	100.	Group	Variable	Annual
Harrow	9000.	9000.	8000.	0.	0.	800.	Group	Variable	Annual
20' Offset Disc	9000.	9000.	8000.	8.	800.	1000.	Group	Variable	Annual
53 GMC 1.5T Trk	200000.	200000.	6000.	15.	50000.	800.	Group	Variable	Annual
Fert Spreader	9000.	9000.	3000.	10.	1000.	400.	Group	Variable	Annual
MM UTS Tractor	9000.	9000.	1000.	20.	4000.	100.	Group	Variable	Annual
4040 JD Tractor	7000.	7100.	15000.	10.	2000.	1300.	Private	Fixed	Annual
850 Ford Tractr	9000.	9000.	1000.	20.	5000.	100.	Group	Variable	Annual
Misc Equipment	9000.	9000.	0.	30.	8000.	0.	Group	Variable	Annual
Augers	9000.	9000.	4500.	5.	100.	400.	Group	Variable	Annual
Steiger Bar III	9000.	9000.	89000.	0.	0.	3960.	Private	Fixed	Annual
JD 7700 Combine	3000.	3500.	87000.	0.	0.	5000.	Private	Fixed	Annual

FIELD OPERATIONS FOR EACH CROP

OPERATIONS FOR MORE THAN ONE CROP

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Spray Grasshop	JUL 1 - JUL 30	.000	.000	.750	.000	.0000	.0000	.000	.000	.000
No equipment used										
This operation was performed for Spring Wheat				Winter Wheat						
Auger to Bins	AUG 15 - SEP 15	.000	.000	.000	.007	.0030	.0030	.000	.000	.000
Augers										
Usage of equipment is based on crop yield										
This operation was performed for Spring Wheat				Winter Wheat		Barley				
Haul to Market	OCT 1 - DEC 31	.000	.000	.000	.040	.0200	.0200	.333	.333	.333
2 1/2 T Truck										
Miles per acre is .0										
Usage of equipment is based on crop yield										
This operation was performed for Spring Wheat				Winter Wheat		Barley				

OPERATIONS PERFORMED SPECIFICALLY FOR Spring Wheat

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Drill Sp Wheat	APR 1 - APR 30	.000	6.000	.000	.500	.1110	.1110	.000	.000	.000
Steiger Bar III										
2 12' Mel Drill										
Herbicide	MAY 15 - JUN 15	.000	.000	3.500	.100	.0200	.0200	.000	.000	.000
Pickup										
P/U Mount Spray										
Harvest SW	AUG 15 - SEP 15	.000	.000	.000	.030	.0040	.0040	.000	.000	.000

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
JD 7700 Combine Usage of equipment is based on crop yield										
Haul Sp Wheat 2 1/2 T Truck Miles per acre is .0 Usage of equipment is based on crop yield	AUG 15 - SEP 15	.000	.000	.000	.020	.0100	.0100	.000	.000	.000
Custom Combine JD 7700 Combine Miles per acre is .0 Usage of equipment is based on crop yield	SEP 1 - SEP 31	-.210	.000	.000	.010	.0050	.0050	.000	.000	.000

OPERATIONS PERFORMED SPECIFICALLY FOR Winter Wheat

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Drill Wn Wheat Steiger Bar III 3 12' JD Drills	OCT 15 - NOV 15	.000	6.000	.000	.500	.1110	.1110	.000	.000	.000
Herbicide Pickup P/U Mount Spray	MAY 1 - MAY 31	.000	.000	3.500	.100	.0200	.0200	.000	.000	.000
Harvest WW JD 7700 Combine Usage of equipment is based on crop yield	AUG 1 - AUG 31	.000	.000	.000	.020	.0060	.0060	.000	.000	.000
Haul W Wheat 2 1/2 T Truck Miles per acre is .0 Usage of equipment is based on crop yield	AUG 1 - AUG 31	.000	.000	.000	.020	.0100	.0100	.333	.333	.333

OPERATIONS PERFORMED SPECIFICALLY FOR Fallow

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Chisel Plow Steiger Bar III 32' Chisel Plw Harrow This operation included on balance sheet under the category 'Value of Crops in Ground'	MAY 1 - MAY 15	.000	.000	.000	.000	.0430	.0030	.000	.000	.000
Plow & Rodweed Steiger Bar III 32' Chisel Plw Rodweeders This operation included on balance sheet under the category 'Value of Crops in Ground'	JUN 7 - JUN 31	.000	.000	.000	.000	.0030	.0030	.000	.000	.000
Plow & Rodweed Steiger Bar III 32' Chisel Plw Rodweeders This operation included on balance sheet under the category 'Value of Crops in Ground'	JUL 10 - JUL 25	.000	.000	000	.000	.0030	.0030	.000	.000	.000
Spray Wild Oats Pickup P/U Mount Spray This operation included on balance sheet under the category 'Value of Crops in Ground'	NOV 1 - NOV 31	.000	.000	2.040	.030	.0100	.0100	.000	.000	.000
Plow & Rodweed Steiger Bar III 32' Chisel Plw Rodweeders This operation included on balance sheet under the category 'Value of Crops in Ground'	SEP 20 - OCT 15	.000	.000	.000	.100	.0630	.0630	.000	.000	.000
Pick Rock 4040 JD Tractor Rockpicker This operation included on balance sheet under the category 'Value of Crops in Ground'	OCT 15 - OCT 30	.000	.000	.000	.300	.0700	.0700	.000	.000	.000
Disk Fields Steiger Bar III Harrow 20' Offset Disc This operation included on balance sheet under the category 'Value of Crops in Ground'	MAR 1 - MAR 31	.000	.000	.000	.000	.0210	.0210	.000	.000	.000

OPERATIONS PERFORMED SPECIFICALLY FOR Barley

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Drill Barley Steiger Bar III 3 12' Mol Drill	MAR 20 - APR 15	.000	6.000	.000	.500	.1110	.1110	.000	.000	.000
Herbicide Pickup P/U Mount Spray	MAY 15 - JUN 15	.000	.000	3.500	.100	.0200	.0200	.000	.000	.000
Harvest Barley JD 7700 Combine Usage of equipment is based on crop yield	AUG 1 - AUG 30	.000	.000	.000	.020	.0060	.0064	.000	.000	.000
Haul Barley 2 1/2 T Truck Miles per acre is .0 Usage of equipment is based on crop yield	AUG 1 - AUG 30	.000	.000	.000	.030	.0100	.0100	.333	.333	.333

OPERATIONS PERFORMED SPECIFICALLY FOR Durum Wheat

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT MATERIALS CHEMICALS
NO SPECIFIC OPERATIONS								

*************************GENERAL FINANCIAL INFORMATION FOR THE FARM**************************

BEGINNING SET OF LONG-TERM ASSETS

ASSET DESCRIPTION	CODE NO.	PURCHASE PRICE	MARKET VALUE	YEAR NEW	YEAR PURCHASED	ACRES	DEPRECIABLE LIFE	SALVAGE VALUE	INSURANCE COST (PER $100 VALUE)
Home Place	1.	130000.	224000.	0.	1988.	640.	0.	0.	.078
INCLUDED WITH THIS LAND ASSET IS:									
House	2.	10000.	15000.	1965.	1980.	0.	0.	0.	.500
8 Grain bins	7.	7000.	10500.	1968.	1980.	0.	20.	2200.	.500
Outbuildings	4.	8000.	11000.	1945.	1980.	0.	20.	1500.	.500

BEGINNING DEBT INFORMATION FOR LONG-TERM ASSETS

ASSET DESCRIPTION	INITIAL PRINCIPAL	CURRENT PRINCIPAL	PAYMENT	PAYMENT PERIOD	INTEREST RATE	RATE TYPE	TOTAL PAYMENTS	PAYMENTS REMAINING	MONTH PAID	FINANCING SOURCE
Home Place	100000	94903.	13722.18	Annual	11.2	Fixed	20.	17.	December	Single
House	0.	0.	.00		.0		0.	0.		
8 Grain bins	0.	0.	.00		.0		0.	0.		
Outbuildings	0.	0.	.00		.0		0.	0.		

OTHER BEGINNING LONG-TERM DEBT COMMITTMENTS TOTAL $ 0.

GROUP LONG-TERM DEBT INFORMATION IS AS FOLLOWS:

Beginning Principal	0.
Time Period Remaining	0. Years
Interest Rate	.0 Percent
Rate Type	Variable
Month Paid	December

MINIMUM CHANGE IN CASH FLOW REQUIRED TO QUALIFY FOR AN OPERATING LOAN

EQUITY RATIO INTERVALS	CHANGE IN CASH FLOW	PREMIUMS ON VARIABLE RATE LOANS
.000 - 1.000	-950000.	.000

Ages of children (in years) are as follows: 16., 8.,

************************GENERAL TAX INFORMATION FOR THE FARM************************

PROPERTY TAX RATES PER THOUSAND DOLLARS ASSESSED VALUE ARE:

Home and buildings	7.690
Farm land	6.460
Equipment and livestock	6.730

MONTHLY LIVING EXPENSES FOR THE FARM FAMILY

Housing	0.	0.
Utilities	105.	60.
Fuel	75.	50.
Food	350.	0.
Medical Insur	200.	0.
Medical Expense	40.	0.
Retirement	0.	0.
Miscellaneous	1075.	25.

PERCENTAGE OF INCOME ALLOCATED TO EACH PERSON FOR TAX PURPOSES

Off-Farm Income	100.
Farm Income	100.
Non-Farm Government Payments	100.
Charitable Contributions	3.

PREVIOUS YEARS TAX PAYMENTS AND CARRYOVER LOSSES

Govt Pension	2600.
Federal Income	1000.
State Income	700.
Carryover Loss	0.

AVERAGE FEDERAL TAX RATES FOR PREVIOUS YEARS

YEAR T-1	.000
YEAR T-2	.000
YEAR T-3	.000
YEAR T-4	.000

MISCELLANEOUS TAX AND OTHER INFORMATION

```
Limit on Section 179 expensing is      10000.
Carryover net operating loss is         0.
Rate for Workmens Compensation Insurance is  10.40
Exchange rate from native currency to $US is     .0000
Previous years personal income for farmer was       0.
Farmer tax status is married, filing jointly
```

BALANCE SHEET FOR THE FARM AS OF DECEMBER 31,1990

ASSETS		LIABILITIES	
CURRENT		CURRENT	
Cash on hand	0.	Ending operating loss	0.
Savings	10000.	Accrued taxes:	
Livestock inventories	0.	Federal	0.
Crop inventories	0.	State	0.
Value of crop in ground	12800.	Self-employment	0.
		Accrued rent	0.
		CCC loan	0.
INTERMEDIATE		INTERMEDIATE	
Machinery value	84516.	Principal owed on machinery	5816.
Breeding livestock value	0.	Principal owed on livestock	0.
LONG TERM		LONG TERM	
Land market value	224000.	Farm mortgage	94903.
Farm buildings	15000.		
Home(s)	21500.		
Off-farm investments	0.		
		TOTAL EQUITY	267097.
TOTAL ASSETS	367816.	TOTAL EQUITY + LIABILITIES	367816.

```
GENERAL FINANCIAL INFORMATION
 Current asset-to-liability ratio      ********
 Intermediate equity ratio                .9312
 Long-term equity ratio                   .6357
 Overall beginning equity ratio           .7262
 Maximum allowable debt ratio
    on any intermediate-term asset        .9000
 Maximum allowable debt ratio
    on any long-term asset                .1000

Discount rate used in calculating NPV is  .100

***********************GENERAL STATISTICAL INFORMATION FOR THE FARM***********************

The Distribution For Spring Wheat   Yield Is Normal

    Mean =30.0000 Std. Error =11.0000

The Distribution For Winter Wheat   Yield Is Normal

    Mean =35.0000 Std. Error =13.0000

The Distribution For Barley         Yield Is Normal

    Mean =45.0000 Std. Error =19.0000

The Distribution For Durum Wheat    Yield Is Normal

    Mean =  .0000 Std. Error =  .0000

The Distribution For Spring Wheat   Price Is Normal

    Mean = 3.7000 Std. Error =  .6000

The Distribution For Winter Wheat   Price Is Normal

    Mean = 3.5900 Std. Error =  .5900

The Distribution For Barley         Price Is Normal

    Mean = 2.1800 Std. Error =  .3300

The Distribution For Durum Wheat    Price Is Normal

    Mean =  .0000 Std. Error =  .0000

The Distribution For Prime interest rate  Is Normal

    Mean =  .1050 Std. Error =  .0000
```

THE FOLLOWING RANDOM VARIABLES ARE TREATED AS DETERMINISTIC IN THE ANALYSIS

VARIABLE NAME		INITIAL VALUE
Fallow	Yield	.000
Fallow	Price	.000
Fuel inflation		1.000
Chemical inflation		1.000
Material inflation		1.000
Labor inflation		1.000
Repair inflation		1.000
New equipment infl.		1.000
Lease equipment inf.		1.000
Per unit cost inf.		1.000
Misc. cost inflation		1.000
Land inflation		1.000
Building inflation		1.000
CPI		1.000
GNP Deflator		1.000
Nat. net farm income		1.000

SCALERS TO CHANGE MEAN OF RANDOM VARIABLES OVER TIME

VARIABLE		1991
Spring Wheat	Yield	1.0000
Winter Wheat	Yield	1.0000
Fallow	Yield	1.0000
Barley	Yield	1.0000
Durum Wheat	Yield	.0000
Spring Wheat	Price	1.0000
Winter Wheat	Price	1.0000
Fallow	Price	1.0000
Barley	Price	1.0000
Durum Wheat	Price	.0000
Prime interest rate		1.0000
Fuel inflation		1.0000
Chemical inflation		1.0000
Material inflation		1.0000
Labor inflation		1.0000
Repair inflation		1.0000
New equipment infl.		1.0000
Lease equipment inf.		1.0000
Per unit cost inf.		1.0000
Misc. cost inflation		1.0000
Land inflation		1.0000
Building inflation		1.0000
CPI		1.0000
GNP Deflator		1.0000
Nat. net farm income		1.0000

SCALERS TO CHANGE VARIANCE OF RANDOM VARIABLES OVER TIME

Spring Wheat	Yield	1.0000
Winter Wheat	Yield	1.0000
Fallow	Yield	1.0000
Barley	Yield	1.0000
Durum Wheat	Yield	.0000
Spring Wheat	Price	1.0000
Winter Wheat	Price	1.0000
Fallow	Price	1.0000
Barley	Price	1.0000
Durum Wheat	Price	.0000
Prime interest rate		1.0000
Fuel inflation		1.0000
Chemical inflation		1.0000
Material inflation		1.0000
Labor inflation		1.0000
Repair inflation		1.0000
New equipment infl.		1.0000
Lease equipment inf.		1.0000
Per unit cost inf.		1.0000
Misc. cost inflation		1.0000
Land inflation		1.0000
Building inflation		1.0000
CPI		1.0000
GNP Deflator		1.0000
Nat. net farm income		1.0000

FIRST CORRELATION MATRIX

Spring Wheat	Yield	.6570	-.1948	.7283
Winter Wheat	Yield	.0000	.5790	.8153
Barley	Yield	.0000	.0000	1.0000

SECOND CORRELATION MATRIX

Spring Wheat	Price	.3906	.4048	.6539	.6101
Winter Wheat	Price	.0000	.3719	.6208	.6901
Barley	Price	.0000	.0000	.8047	.5937
Prime interest rate		.0000	.0000	.0000	1.0000

Seed for random number generator is 46798.

TARGET PRICE

CROP NAME	1991
Spring Wheat	3.9600
Winter Wheat	3.9600
Fallow	.0000
Barley	2.3600
Durum Wheat	.0000

FIXED LOAN RATES

Spring Wheat	2.0000
Winter Wheat	2.0000
Fallow	.0000
Barley	1.3200
Durum Wheat	.0000

REQUIRED ACREAGE IN SET-ASIDE (PERCENT)

Spring Wheat	15.0000
Winter Wheat	15.0000
Fallow	.0000
Barley	7.5000
Durum Wheat	.0000

OPTIONAL ACREAGE IN PAID DIVERSION (PERCENT)

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PAYMENT RATE/ACRE ON PAID DIVERSION

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

OPTIONAL ACREAGE IN PIK DIVERSION (PERCENT)

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PAYMENT RATE/ACRE ON PIK DIVERSION

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

MAXIMUM REDUCTION IN FORMULA LOAN WHEN CALCULATING ADJUSTED LOAN (PERCENT)

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

STORAGE COSTS FOR CCC LOANS

Spring Wheat	.0300
Winter Wheat	.0300
Fallow	.0000
Barley	.0300
Durum Wheat	.0000

MINIMUM LEVELS FOR FORMULA LOANS

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

MINIMUM REDUCTIONS IN FORMULA LOANS FROM PREVIOUS YEAR (IN PERCENT)

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PERCENT OF MEAN HISTORICAL MARKET PRICE USED TO CALCULATE FLEXIBLE LOANS

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PERCENT OF BASE ACREAGE ELIGIBLE FOR DEFICIENCY PAYMENTS

Spring Wheat	80.0000
Winter Wheat	80.0000
Fallow	80.0000
Barley	80.0000
Durum Wheat	.0000

PRODUCTION SLIPPAGE ON IDLED ACREAGE (PERCENT)

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PER ACRE CONSERVATION RESERVE PAYMENTS BY CROP

pring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

FIXED MARKETING LOAN - REPAYMENT LEVEL AS A PERCENT OF NONRECOURSE LOAN

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

VARIABLE MARKETING LOAN - DIFFERENCE BETWEEN WORLD PRICE AND MARKET PRICE

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PERCENT OF ADVANCE DEFICIENCY AND FINLEY PAYMENTS PAID IN PIK CERTIFICATES

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

PERCENT OF REMAINING DEFICIENCY AND FINLEY PAYMENTS PAID IN PIK CERTIFICATES

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

CROP INSURANCE GUARANTEED YIELD LEVELS (PERCENT)

Spring Wheat	75.0000
Winter Wheat	75.0000
Fallow	.0000
Barley	65.0000
Durum Wheat	.0000

CROP INSURANCE PRICE ELECTION

Spring Wheat	3.4500
Winter Wheat	3.4500
Fallow	.0000
Barley	2.1000
Durum Wheat	.0000

CROP INSURANCE PREMIUM (PER $100 COVERAGE)

Spring Wheat	6.6000
Winter Wheat	6.7000
Fallow	.0000
Barley	6.0000
Durum Wheat	.0000

GRAMM-RUDMAN PAYMENT REDUCTION LEVELS (PERCENT)

0.

PAYMENT LIMITATIONS:

Deficiency payment	50000.
Finley payment	200000.

HISTORICAL YIELDS USED TO CALCULATE PROVEN YIELD

CROP NAME	1990	1989	1988	1987	1986
Spring Wheat	31.40	17.70	36.80	35.50	10.90
Winter Wheat	36.50	18.10	40.20	40.20	16.60
Fallow	.00	.00	.00	.00	.00
Barley	41.00	25.20	54.10	43.20	16.80
Durum Wheat	.00	.00	.00	.00	.00

HISTORICAL PRICES USED TO CALCULATE VARIABLE LOANS

Spring Wheat	.00	.00	.00	.00	.00
Winter Wheat	.00	.00	.00	.00	.00
Fallow	.00	.00	.00	.00	.00
Barley	.00	.00	.00	.00	.00
Durum Wheat	.00	.00	.00	.00	.00

FORMULA LOAN FOR 1990:

Spring Wheat	=	.000
Winter Wheat	=	.000
Fallow	=	.000
Barley	=	.000
Durum Wheat	=	.000

PERCENT OF GROSS REVENUE SUBTRACTED TO PARTICIPATE IN GOVERNMENT PROGRAM

Spring Wheat	.0000
Winter Wheat	.0000
Fallow	.0000
Barley	.0000
Durum Wheat	.0000

MONTHS IN WHICH THE FOLLOWING TRANSACTIONS AREPERFORMED

BUSINESS ACTIVITY	Spring Wheat	Winter Wheat	Fallow	Barley	Durum Wheat
Crop placed in loan	October	October	October	October	October
Crop taken out of regular loan	March	March	March	March	March
PIK certificates sold					
CRP payments received					
Marketing loan repaid					
Crop insurance premiums paid	September	September	September	September	September
Crop insurance indemnities pd	September	September	September	September	September

40.0 percent of the deficiency payment is paid in March
, with the remainder paid in December

CASH FLOW STATEMENT FOR 1991

CASH AVAILABLE	January	February	March	April	May	June	July	August	September	October	November	December
Beginning Cash	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	100.	0.
Milk and Livestock Prod	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Crop receipts	0.	0.	0.	0.	0.	0.	0.	0.	4207.	6376.	18736.	21691.
Cull Livestock Sales	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Direct Government Paymt	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Direct Government Loans	0.	0.	0.	0.	0.	0.	0.	0.	0.	18664.	0.	0.
Other Government Paymts	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Miscellaneous Income	0.	0.	0.	0.	0.	0.	0.	0.	16209.	0.	0.	0.
TOTAL AVAILABLE CASH	0.	0.	0.	0.	0.	0.	0.	0.	20416.	25040.	18836.	21691.
CASH REQUIRED												
Per Unit Costs	0.	0.	0.	0.	0.	0.	0.	0.	-1697.	-61.	0.	0.
Feed Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Misc. Livestock Expense	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Material Costs	0.	0.	444.	4236.	0.	0.	0.	0.	0.	127.	127.	0.
Chemical Costs	0.	0.	0.	0.	1676.	1527.	478.	0.	0.	0.	2068.	74.
Fuel Costs	0.	0.	49.	333.	777.	773.	735.	515.	406.	858.	338.	305.
Labor Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Insurance Premiums	0.	0.	576.	939.	0.	576.	0.	0.	4382.	0.	0.	576.
Repair Costs	0.	0.	289.	813.	506.	683.	652.	2941.	2881.	663.	135.	5.
Equipment Lease Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Equipment Down Payment	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Land Cash Rent Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Net Cash Withdrawals	1645.	1645.	1645.	1645.	1645.	1645.	1645.	1645.	1645.	1645.	1645.	1645.
Misc. Crop Expenses	0.	0.	250.	200.	200.	200.	200.	200.	0.	0.	0.	0.
Loan payments:												
Intermediate	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	2153.
Long-term	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	12722.
Government Loans	0.	0.	0.	0.	0.	0.	0.	0.	0.	3216.	5380.	10800.
Tax payments:												
Federal income	0.	0.	250.	0.	0.	250.	0.	0.	250.	0.	0.	250.
State income	0.	0.	175.	0.	0.	175.	0.	0.	175.	0.	0.	175.
Local property	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	2297.	0.
Self-employment	0.	0.	650.	0.	0.	650.	0.	0.	650.	0.	0.	650.
TOTAL REQUIREMENTS	1645.	1645.	4327.	8167.	4804.	6479.	3710.	5300.	8694.	6448.	19982.	29355.
TOTAL AVAILABLE CASH LESS TOTAL REQUIREMENTS	-1645.	-1645.	-4327.	-8167.	-4804.	-6479.	-3710.	-5300.	11722.	18592.	-1146.	-7664.
PLUS: Cash from savings	1645.	1645.	4327.	2517.	0.	0.	0.	0.	0.	0.	1146.	2243.
NET CASH POSITION	0.	0.	0.	-5650.	-4804.	-6479.	-3710.	-5300.	11722.	18592.	0.	-5421.
LESS: Cash added to savings	0.	0.	0.	0.	0.	0.	0.	0.	0.	3434.	0.	685.
LESS: Cash used to reduce operating loan	0.	0.	0.	0.	0.	0.	0.	0.	11722.	15058.	0.	0.
ADD: Transfer to operating loan	0.	0.	0.	5650.	4804.	6479.	3710.	5300.	0.	0.	0.	5421.
ENDING CASH ON HAND	0.	0.	0.	0.	0.	0.	0.	0.	0.	100.	0.	100.
ENDING STATUS (PRINCIPAL + INTEREST)												
Savings	8412.	6815.	2517.	0.	0.	0.	0.	0.	0.	3372.	2243.	0.
Operating loan	0.	0.	0.	5669.	10550.	17161.	23053.	26581.	15058.	0.	0.	5440.

PERSONAL INCOME STATEMENT FOR EACH YEAR

	1991
CASH FARM INCOME	
Crop Receipts	43009.
Milk and Livestock Receipts	0.
Direct Government Payments	0.
Crop Insurance Indemnities	16209.
Direct Government Loans	18664.
Less: Repayment of Goverment Loans	19187.
Other Farm Income	0.
Savings Interest	179.
Other Government Payments	0.
TOTAL CASH RECEIPTS	58874.
CASH FARM EXPENSES	
Per Unit	-1758.
Materials	4935.
Chemicals	5823.
Fuel	5082.
Labor	0.
Insurance Premiums	7048.
Feed Purchases	0.
Misc. Livestock Expenses	0.
Equipment Repair	9567.
Equipment Lease	0.
Cash Rent	0.
Interest:	
Operating Loan	943.
Equipment and Livestock	611.
Land and Buildings	10629.
Other	210.
Property Taxes	2297.
Misc. Crop Expenses	1250.
TOTAL CASH EXPENSES	46636.
NET CASH FARM INCOME	12238.
+ Ending crop inventories	0.
+ Change in value of crops in ground	82.
- Economic depreciation	
Equipment	10330.
Long term assets	865.
= NET FARM INCOME	1125.
- Federal income tax	-872.
- Social security	738.
- All state taxes	0.
= NET INCOME AFTER TAXES (NIAT)	1259.
+ Land capital gains	0.
= NIAT AND CAPITAL GAINS	1259.
- Net family withdrawals	19740.
+ Change in nonfarm net worth	0.
= CHANGE IN TOTAL NET WORTH	-18481.

TAX INCOME STATEMENT FOR EACH YEAR

	1991
CALCULATION OF BUSINESS TAXABLE INCOME:	
Net cash farm income	12238.
- Depreciation:	
Equipment	3330.
Buildings	504.
Section 179 expensing	0.
- Business savings interest	179.
- Tax-deductable living expenses	4300.
Farm income from Schedule F	3925.

INCOME TAX STATEMENT FOR SOLE PROPRIETOR

Taxable income from farm	3925.
+ Off-farm income	2400.
+ Non-Farm Govt Payments	0.
+ Depreciation recapture	0.
+ Interest on savings	179.
- Half of self-employment Soc Sec	277.
- Deductions + exemptions	14300.
Taxable income	-8073.

1

MARKET VALUE BALANCE SHEET

	INITIAL	1991
ASSETS:		
Ending cash on hand	0.	100.
Ending cash in savings	10000.	0.
Ending crop inventories	0.	0.
Value of crop in ground	12800.	12882.
Market value of machinery	84516.	74186.
Market value of land	224000.	224000.
Market value of residence	15000.	14644.
Market value of buildings	21500.	20990.
Mkt. value of off-farm invest.	0.	0.
TOTAL VALUE OF ASSETS	367816.	346803.
LIABILITIES:		
Outstanding operating loan	0.	5440.
Accrued taxes		
-Federal	0.	-1872.
-State	0.	-700.
-Self-employment	0.	-1862.
Outstanding Government loan	0.	0.
Machinery debt	5816.	4273.
Land and buildings debt	94903.	92810.
TOTAL LIABILITIES	100719.	98089.
EQUITY	267097.	248714.
EQUITY PLUS LIABILITIES	367816.	346803.

THE FARM MANAGEMENT SIMULATION MODEL

DEVELOPED AT OREGON STATE UNIVERSITY

BY
GREGORY M. PERRY

VERSION 2.0, JUNE 1990

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*****************************************************************************
        FAMSIM ANALYSIS FOR REPRESENTATIVE NEW SOUTH WALES, AUSTRALIA FARM
        BASED ON DATA OBTAINED FROM                                NSW
        FARM CONTAINS 2000 ACRES OF LAND, IN SPRING WHEAT AND BARLEY
        US TAXES IMPOSED ON FARM
 The simulation is for  1 years, with the first year being 1991
 The simulation is stochastic, with  25 iterationsspecified
 There are    5 crops included in the model
 There are  9 regular variables in the model treated as stochastic.  all
    others are assumed known with certainty;
    Of these stochastic variables,  2 are correlated using one correlation matrix.
    A second set of  2 variables are correlated usiing a second correlation matrix.  The two matrices
    are assumed independent of one another.
 There are  1 ASCS farm units within this operation.
 There are     2 long-term assets in the model.
 There are    12 pieces of equipment in the complement
 Farm is located in Australia for tax purposes.
 Farm is a partnership for tax purposes and has 2 partners.
 Expensing will not be used to reduce depreciable basis.
 Proven yields are average of previous proven yields.
 No attempt will be made to improve projected cash-flow statement if it does not meet criteria for operating loan.
 The following information will be printed:
  - All input data
  - Only the final cash flow, income, and balance sheet statements
  - Statistical information on all output variables
 ************************************GENERAL PRODUCTION INFORMATION**********************************
```

ACREAGE BY ASCS OR OTHER SUBFARM UNIT

```
**********ASCS Farm Unit # 1
        Name:  HOME ACREAGE
        Land Status: OWNED                    Asset Number:  1.
```

ACREAGE

CROP NAME	1991
Spring Wheat	1500.
Fallow	0.
Oats	0.
Barley	500.
Blank	0.

CROP NAME	OPTIONAL ACREAGE IDLEMENT #1	OPTIONAL ACREAGE PROGRAM #2	PROGRAM PARTICIPATION BY YEAR 1991
Spring Wheat			NO
Fallow			NO
Oats			NO
Barley			NO
Blank			NO

DIFFERENCE BETWEEN THE FOLLOWING INTEREST RATES
AND THE PRIME RATE

TYPE OF INTEREST	1991
Variable operating	.010
Variable savings	-.030
Variable int. term	-.050
Fixed intermed. term	.000
Variable long term	.000
Fixed long term	.000
CCC loan	.000

OFF-FARM INCOME AND MISCELLANEOUS EXPENSES

ITEM	January	February	March	April	May	June	July	August	September	October	November	December
Off-farm income	0.	0.	0.	0.	0.	0.	0.	0.	0.		0.	0.
Miscellaneous exp.	100.	200.	375.	300.	100.	100.	100.	100.	100.	[illegible]	100.	100.

LABOR SUPPLY AND COST

ITEM	January	February	March	April	May	June	July	August	September	October	November	December
Family labor (free)	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.	300.
Family labor (paid)	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Full-time hired help	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Family labor salary	0.	0.	C.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Hired salary per man	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.

```
Hourly labor receives $  5.50 per hour
Farm employs  0. full-time laborers.
Fuel costs are $  1.30/gallon.


************************************ MARKETING INFORMATION FOR CROPS************************************
```

PROPORTION OF CROP SOLD EACH MONTH OF MARKETING YEAR

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	.030	.000	.250	.020	.000	.000	.030	.000	.000	.020	.000	.650
Fallow	.000	.000	.000	.000	.000	1.000	.000	.000	.000	.000	.000	.650
Oats	.000	.000	.000	.000	.000	1.000	.000	.000	.000	.000	.000	.650
Barley	.030	.000	.250	.020	.000	.000	.030	.000	.000	.020	.000	.650
Blank	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000

MONTHLY PRICE INDICES FOR CROPS

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Fallow	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Oats	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Barley	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Blank	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000

MONTHLY PREMIUM INDICES FOR PIK CERTIFICATES

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Fallow	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Oats	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Barley	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Blank	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000

PROPORTION OF CROP HARVESTED BY MONTH

CROP	January	February	March	April	May	June	July	August	September	October	November	December
Spring Wheat	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Fallow	1.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Oats	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Barley	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
Blank	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000

CROP	BEGINNING STOCKS	EXPECTED PRICE FOR STOCKS	FIRST MARKETING MONTH	LIVESTOCK FEED	STORABLE CROP
Spring Wheat	0.	.000	January	NO	YES
Fallow	0.	.000	January	NO	YES
Oats	0.	.000	January	NO	YES
Barley	0.	.000	January	NO	YES
Blank	0.	.000	January	NO	YES

**********************************EQUIPMENT AND FIELD OPERATIONS**********************************

BEGINNING EQUIPMENT COMPLEMENT

EQUIPMENT NAME	CODE NO.	PURCHASE PRICE'	YEAR NEW	YEAR BOUGHT	INITIAL HOURS	MAXIMUM HOURS	PERCENT USAGE	REP. COST SCALAR	SALVAGE VALUE	DEPRECIATION PERIOD	AMOUNT DEPRECIATED	INSUR-ANCE
Case 4994 Tract	7.	97000.	1984.	1984.	3000.	300.	1.000	1.00	0.	0.	86321.	3.13
40' Chisel Plow	26.	15000.	1978.	1978.	3000.	300.	1.000	.10	0.	0.	13000.	.00
Rodweeders	32.	4000.	1980.	1980.	5000.	300.	1.000	.50	0.	0.	3331.	.00
IH 1460 Combine	39.	135400.	1981.	1981.	2400.	300.	1.000	1.00	0.	0.	120011.	3.13
IH 28 run Drill	35.	5300.	1977.	1977.	1500.	300.	1.000	.15	0.	0.	4751.	.00
40 HWP Tractor	1.	10000.	1978.	1978.	1300.	300.	1.000	1.00	0.	0.	9636.	.00
15' Scarifier	28.	3500.	1976.	1976.	1000.	300.	1.000	1.00	0.	0.	3303.	.00
60' Sprayer	54.	4900.	1988.	1988.	300.	300.	1.000	3.00	0.	0.	3190.	.00
IH 3070 Truck	63.	35400.	1983.	1980.	330000.	2000.	.000	.50	0.	0.	35363.	1.00
Truck	62.	2700.	1975.	1965.	600000.	2000.	.200	.50	0.	0.	2656.	1.00
Other equipment	70.	95000.	1980.	1975.	0.	300.	1.000	.25	0.	0.	70103.	.00
Landcruiser	66.	31000.	1986.	1986.	60000.	3000.	1.000	.50	0.	0.	15065.	1.00

DEBT INFORMATION ON BEGINNING COMPLEMENT

NAME	FINANCING SOURCE	PAYMENT SCHEDULE	INTEREST RATE	RATE TYPE	PAYMENT	AMOUNT FINANCED	CURRENT PRINCIPAL	TOTAL PAYMENTS	PAYMENTS REMAINING	MONTH PAID
Case 4994 Tract	Group		.00		.00	0.	0.	0.	0.	
40' Chisel Plow	Group		.00		.00	0.	0.	0.	0.	
Rodweeders	Group		.00		.00	0.	0.	0.	0.	
IH 1460 Combine	Group		.00		.00	0.	0.	0.	0.	
IH 28 run Drill	Group		.00		.00	0.	0.	0.	0.	
40 HWP Tractor	Group		.00		.00	0.	0.	0.	0.	
15' Scarifier	Group		.00		.00	0.	0.	0.	0.	
60' Sprayer	Group		.00		.00	0.	0.	0.	0.	
IH 3070 Truck	Group		.00		.00	0.	0.	0.	0.	
Truck	Group		.00		.00	0.	0.	0.	0.	
Other equipment	Group		.00		.00	0.	0.	0.	0.	
Landcruiser	Group		.00		.00	0.	0.	0.	0.	

OTHER BEGINNING INTERMEDIATE DEBT COMMITTMENTS TOTALS 0.

GROUP INTERMEDIATE DEBT INFORMATION IS AS FOLLOWS:

Beginning Principal	0.
Time Period Remaining	5. Years
Interest Rate	.0 Percent
Rate Type	Variable
Month Paid	December

Insurance premiums for farm assets are paid in October

REPLACEMENT INFORMATION FOR EQUIPMENT

EQUIPMENT NAME	HOURS AT TRADEIN	MAXIMUM HOURS	REPLACEMENT COST	AGE WHEN PURCHASED	HOURS WHEN PURCHASED	LEASE COST ($/MONTH)	FINANCING SOURCE	TYPE OF RATE	PAYMENT SCHEDULE
Case 4994 Tract	10000.	11000.	146087.	0.	0.	2500.	Private	Fixed	Annual
40' Chisel Plow	9000.	9000.	30000.	0.	0.	1500.	Group	Variable	Annual
Rodweeders	9000.	9000.	8000.	0.	0.	300.	Group	Variable	Annual
IH 1460 Combine	9000.	9000.	142200.	0.	0.	2000.	Group	Variable	Annual
IH 28 run Drill	9000.	9000.	15000.	0.	0.	800.	Group	Variable	Annual

40 HWP Tractor	9000.	9000.	20000.	0.	0.	900.	Group	Variable	Annual
15' Scarifier	9000.	9000.	7000.	0.	0.	400.	Group	Variable	Annual
60' Sprayer	9000.	9000.	4500.	0.	0.	300.	Group	Variable	Annual
IH 3070 Truck	900000.	900000.	50000.	0.	0.	800.	Group	Variable	Annual
Truck	900000.	900000.	6000.	10.	80000.	500.	Group	Variable	Annual
Other equipment	9000.	9000.	95000.	0.	0.	399.	Group	Variable	Annual
Landcruiser	150000.	150000.	31000.	0.	0.	400.	Group	Variable	Annual

FIELD OPERATIONS FOR EACH CROP

OPERATIONS FOR MORE THAN ONE CROP

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Spray Roundup Landcruiser 60' Sprayer This operation was performed for Spring Wheat Barley	NOV 15 - DEC 15	.000	.000	5.500	.030	.0170	.0170	.000	.000	.000
Plough Case 4994 Tract 40' Chisel Plow This operation was performed for Spring Wheat Barley	DEC 1 - DEC 30	.000	.000	.000	.500	.0370	.0370	.000	.000	.000
Scarify Case 4994 Tract 15' Scarifier This operation was performed for Spring Wheat Barley	FEB 1 - FEB 30	.000	.000	.0)	.330	.0320	.0320	.000	.000	.000
Scarify Case 4994 Tract 15' Scarifier This operation was performed for Spring Wheat Barley	MAR 1 - MAR 30	.000	.000	.000	.330	.0320	.0320	.000	.000	.000
Wide line Cult Case 4994 Tract Rodweeders This operation was performed for Spring Wheat Barley	APR 1 - APR 30	.000	.000	.000	.250	.0120	.0120	.000	.000	.000
Custom Fert No equipment used This operation was performed for Spring Wheat Barley	MAR 15 - APR 15	.000	.000	8.750	.000	.0000	.0000	.000	.000	.000

OPERATIONS PERFORMED SPECIFICALLY FOR Spring Wheat

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Wide line Cult Case 4994 Tract Rodweeders	MAY 1 - MAY 30	.000	.000	.000	.350	.0120	.0120	.000	.000	.000
Plant Wheat Case 4994 Tract IH 30 run Drill	MAY 1 - MAY 30	.000	2.720	.000	.300	.0030	.0030	.000	.000	.000
Spray 60% Landcruiser 60' Sprayer	JUN 15 - JUL 15	.000	300	9.700	.030	.0170	.0170	.000	.000	.000
Harvest Wheat IH 1460 Combine Usage of equipment is based on crop yield	NOV 15 - DEC 15	.000	.000	.000	.011	.0030	.0030	.000	.000	.000

OPERATIONS PERFORMED SPECIFICALLY FOR Fallow

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS

NO SPECIFIC OPERATIONS

OPERATIONS PERFORMED SPECIFICALLY FOR Oats

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS

NO SPECIFIC OPERATIONS

OPERATIONS PERFORMED SPECIFICALLY FOR Barley

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS
Plant Barley Case 4994 Tract IH 30 run Drill	APR 1 - APR 30	.000	.000	3.500	.300	.0030	.0030	.000	.000	.000
Harvest Barley IH 1460 Combine Usage of equipment is based on crop yield	NOV 1 - NOV 30	.000	.000	[illegible]	.011	.0030	.0030	.000	.000	.000

OPERATIONS PERFORMED SPECIFICALLY FOR Blank

OPERATION NAME/ EQUIPMENT USED	TIME PERIOD ACCOMPLISHED	COST /UNIT	MATERIALS COST/ACRE	CHEMICAL COST/AC	FUEL USE (GAL/AC)	FIELD TIME (HRS/ACRE)	LABOR USE (HRS/AC)	PERCENT COSTS PAID BY LANDLORD PER UNIT	MATERIALS	CHEMICALS

NO SPECIFIC OPERATIONS

************************GENERAL FINANCIAL INFORMATION FOR THE FARM************************

BEGINNING SET OF LONG-TERM ASSETS

ASSET DESCRIPTION	CODE NO.	PURCHASE PRICE	MARKET VALUE	YEAR NEW	YEAR PURCHASED	ACRES	DEPRECIABLE LIFE	SALVAGE VALUE	INSURANCE COST (PER $100 VALUE)
Home Place	1.	150000.	520000.	0.	1975.	2100.	0.	0.	1.030
INCLUDED WITH THIS LAND ASSET IS:									
House	2.	10000.	15000.	1965.	1975.	0.	0.	0.	2.500

BEGINNING DEBT INFORMATION FOR LONG-TERM ASSETS

ASSET DESCRIPTION	INITIAL PRINCIPAL	CURRENT PRINCIPAL	PAYMENT	PAYMENT PERIOD	INTEREST RATE	RATE TYPE	TOTAL PAYMENTS	PAYMENTS REMAINING	MONTH PAID	FINANCING SOURCE
Home Place	28009.	15000.	4474.73	Annual	15.0	Fixed	20.	5.	December	Single
House	0.	0.	.00		.0		0.	0.		

OTHER BEGINNING LONG-TERM DEBT COMMITTMENTS TOTAL $ 0.

GROUP LONG-TERM DEBT INFORMATION IS AS FOLLOWS:

Beginning Principal	0.
Time Period Remaining	0. Years
Interest Rate	.0 Percent
Rate Type	Variable
Month Paid	December

MINIMUM CHANGE IN CASH FLOW REQUIRED TO QUALIFY FOR AN OPERATING LOAN

EQUITY RATIO INTERVALS	CHANGE IN CASH FLOW	PREMIUMS ON VARIABLE RATE LOANS
.000 - 1.000	-90000.	.000

Ages of children (in years) are as follows: 16., 8..

************************GENERAL TAX INFORMATION FOR THE FARM************************

PROPERTY TAX RATES PER THOUSAND DOLLARS ASSESSED VALUE ARE:

Home and buildings	3.500
Farm land	3.500
Equipment and livestock	.000

MONTHLY LIVING EXPENSES FOR EACH PARTNER

	Partner #1	% Exempt	Partner #2	% Exempt
Housing	0.	0.	0.	0.
Utilities	93.	60.	0.	60.
Fuel	295.	50.	0.	50.
Food	490.	0.	0.	0.
Medical Insur	38.	0.	0.	0.
Medical Expense	40.	0.	0.	0.
Retirement	0.	0.	0.	0.
Miscellaneous	2141.	25.	0.	25.

PERCENTAGE OF INCOME ALLOCATED TO EACH PERSON FOR TAX PURPOSES

	Partner #1	Partner #2	Partner #3
Off-Farm Income	0.	100.	
Farm Income	50.	50.	
Non-Farm Government Payments	0.	100.	
Charitable Contributions	3.	3.	

PREVIOUS YEARS TAX PAYMENTS AND CARRYOVER LOSSES

Govt Pension	500.	500.
Federal Income	16000.	16000.
State Income	0.	0.
Carryover Loss	0.	0.

AVERAGE FEDERAL TAX RATES FOR PREVIOUS YEARS

YEAR T-1	.370	.370
YEAR T-2	.370	.370
YEAR T-3	.370	.370
YEAR T-4	.370	.370

INCOME EQUALISATION DEPOSIT INFORMATION

Income Breakpt	99100.	99100.
Beginning Bal	5000.	5000.

MISCELLANEOUS TAX AND OTHER INFORMATION

Limit on Section 179 expensing is 10000.
Carryover net operating loss is 0.

Rate for Workmens Compensation Insurance is .00
Exchange rate from native currency to $US is .7900
Previous years personal income for farmer was 63000.
Each partner assumed tax status is married, filing separately

BALANCE SHEET FOR THE FARM AS OF DECEMBER 31,1990

ASSETS		LIABILITIES	
CURRENT		CURRENT	
Cash on hand	0.	Ending operating loss	0.
Savings	10000.	Accrued taxes:	
Livestock inventories	0.	Federal	0.
Crop inventories	0.	State	0.
Value of crop in ground	0.	Self-employment	0.
		Accrued rent	0.
		CCC loan	0.
INTERMEDIATE		INTERMEDIATE	
Machinery value	172918.	Principal owed on machinery	0.
Breeding livestock value	0.	Principal owed on livestock	0.
LONG TERM		LONG TERM	
Land market value	520000.	Farm mortgage	15000.
Farm buildings	15000.		
Home(s)	0.		
Off-farm investments	0.		
		TOTAL EQUITY	702918.
TOTAL ASSETS	717918.	TOTAL EQUITY + LIABILITIES	717918.

GENERAL FINANCIAL INFORMATION	
Current asset-to-liability ratio	********
Intermediate equity ratio	1.0000
Long-term equity ratio	.9720
Overall beginning equity ratio	.9791
Maximum allowable debt ratio on any intermediate-term asset	.9000
Maximum allowable debt ratio on any long-term asset	.1000

Discount rate used in calculating NPV is .100

************************GENERAL STATISTICAL INFORMATION FOR THE FARM************************

The Distribution For Spring Wheat Yield Is Normal

Mean =35.9000 Std. Error =18.9700

The Distribution For Fallow Yield Is Normal

Mean = .0000 Std. Error = .0000

The Distribution For Barley Yield Is Normal

Mean =39.9000 Std. Error =19.3900

The Distribution For Blank Yield Is Normal

Mean = .0000 Std. Error = .0000

The Distribution For Spring Wheat Price Is Normal

Mean = 2.9800 Std. Error = .6600

The Distribution For Fallow Price Is Normal

Mean = .0000 Std. Error = .0000

The Distribution For Barley Price Is Normal

Mean = 2.3800 Std. Error = .6700

The Distribution For Blank Price Is Normal

Mean = .0000 Std. Error = .0000

The Distribution For Prime interest rate Is Normal

Mean = .1500 Std. Error = .0000

THE FOLLOWING RANDOM VARIABLES ARE TREATED AS DETERMINISTIC IN THE ANALYSIS

VARIABLE NAME		INITIAL VALUE
Oats	Yield	.000
Oats	Price	.000
Fuel inflation		1.000
Chemical inflation		1.000
Material inflation		1.000
Labor inflation		1.000
Repair inflation		1.000

New equipment infl.	1.000
Lease equipment inf.	1.000
Per unit cost inf.	1.000
Misc. cost inflation	1.000
Land inflation	1.000
Building inflation	1.000
CPI	1.000
GNP Deflator	1.000
Nat. net farm income	1.000

SCALERS TO CHANGE MEAN OF RANDOM VARIABLES OVER TIME

VARIABLE		1991
Spring Wheat	Yield	1.0000
Fallow	Yield	1.0000
Oats	Yield	1.0000
Barley	Yield	1.0000
Blank	Yield	1.0000
Spring Wheat	Price	1.0000
Fallow	Price	1.0000
Oats	Price	1.0000
Barley	Price	1.0000
Blank	Price	1.0000
Prime interest rate		1.0000
Fuel inflation		1.0000
Chemical inflation		1.0000
Material inflation		1.0000
Labor inflation		1.0000
Repair inflation		1.0000
New equipment infl.		1.0000
Lease equipment inf.		1.0000
Per unit cost inf.		1.0000
Misc. cost inflation		1.0000
Land inflation		1.0000
Building inflation		1.0000
CPI		1.0000
GNP Deflator		1.0000
Nat. net farm income		1.0000

SCALERS TO CHANGE VARIANCE OF RANDOM VARIABLES OVER TIME

Spring Wheat	Yield	1.0000
Fallow	Yield	1.0000
Oats	Yield	1.0000
Barley	Yield	1.0000
Blank	Yield	1.0000
Spring Wheat	Price	1.0000
Fallow	Price	1.0000
Oats	Price	1.0000
Barley	Price	1.0000
Blank	Price	1.0000
Prime interest rate		1.0000
Fuel inflation		1.0000
Chemical inflation		1.0000
Material inflation		1.0000
Labor inflation		1.0000
Repair inflation		1.0000
New equipment infl.		1.0000
Lease equipment inf.		1.0000
Per unit cost inf.		1.0000
Misc. cost inflation		1.0000
Land inflation		1.0000
Building inflation		1.0000
CPI		1.0000
GNP Deflator		1.0000
Nat. net farm income		1.0000

FIRST CORRELATION MATRIX

Spring Wheat	Yield	.7546	.4954
Barley	Yield	.0000	1.0000

SECOND CORRELATION MATRIX

Spring Wheat	Price	.4283	.7561
Barley	Price	.0000	1.0000

Seed for random number generator is 46798.

CROP NAME	1991
TARGET PRICES	
Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

FIXED LOAN RATES	
Spring Wheat	.0000
Fallow	.0000

Oats	.0000
Barley	.0000
Blank	.0000

REQUIRED ACREAGE IN SET-ASIDE (PERCENT)

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

OPTIONAL ACREAGE IN PAID DIVERSION (PERCENT)

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PAYMENT RATE/ACRE ON PAID DIVERSION

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

OPTIONAL ACREAGE IN PIK DIVERSION (PERCENT)

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PAYMENT RATE/ACRE ON PIK DIVERSION

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

MAXIMUM REDUCTION IN FORMULA LOAN WHEN CALCULATING ADJUSTED LOAN (PERCENT)

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

STORAGE COSTS FOR CCC LOANS

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

MINIMUM LEVELS FOR FORMULA LOANS

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

MINIMUM REDUCTIONS IN FORMULA LOANS FROM PREVIOUS YEAR (IN PERCENT)

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PERCENT OF MEAN HISTORICAL MARKET PRICE USED TO CALCULATE FLEXIBLE LOANS

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PERCENT OF BASE ACREAGE ELIGIBLE FOR DEFICIENCY PAYMENTS

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PRODUCTION SLIPPAGE ON IDLED ACREAGE (PERCENT)

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PER ACRE CONSERVATION RESERVE PAYMENTS BY CROP

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

FIXED MARKETING LOAN -
REPAYMENT LEVEL AS A PERCENT OF NONRECOURSE LOAN

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

VARIABLE MARKETING LOAN -
DIFFERENCE BETWEEN WORLD PRICE AND MARKET PRICE

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PERCENT OF ADVANCE DEFICIENCY AND FINLEY PAYMENTS
PAID IN PIK CERTIFICATES

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

PERCENT OF REMAINING DEFICIENCY AND FINLEY PAYMENTS
PAID IN PIK CERTIFICATES

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

CROP INSURANCE GUARANTEED YIELD LEVELS (PERCENT)

Spring Wheat	75.0000
Fallow	.0000
Oats	.0000
Barley	75.0000
Blank	.0000

CROP INSURANCE PRICE ELECTION

Spring Wheat	2.5000
Fallow	.0000
Oats	.0000
Barley	2.5000
Blank	.0000

CROP INSURANCE PREMIUM (PER $100 COVERAGE)

Spring Wheat	6.0000
Fallow	.0000
Oats	.0000
Barley	6.0000
Blank	.0000

GRAMM-RUDMAN PAYMENT REDUCTION LEVELS (PERCENT)
0.

PAYMENT LIMITATIONS:

Deficiency payment	0.
Finley payment	0.

HISTORICAL YIELDS USED TO CALCULATE PROVEN YIELD

CROP NAME	1990	1989	1988	1987	1986
Spring Wheat	44.10	44.10	36.70	45.90	.00
Fallow	.00	.00	.00	.00	.00
Oats	.00	.00	.00	.00	.00
Barley	39.70	30.90	35.30	67.00	.00
Blank	.00	.00	.00	.00	.00

HISTORICAL PRICES USED TO CALCULATE VARIABLE LOANS

Spring Wheat	.00	.00	.00	.00	.00
Fa..	.00	.00	.00	.00	.00
Oats	.00	.00	.00	.00	.00
Barley	.00	.00	.00	.00	.00
Blank	.00	.00	.00	.00	.00

FORMULA LOAN FOR 1990:

Spring Wheat	=	.000
Fallow	=	.000
Oats	=	.000
Barley	=	.000
Blank	=	.000

PERCENT OF GROSS REVENUE SUBTRACTED TO PARTICIPATE IN GOVERNMENT PROGRAM

Spring Wheat	.0000
Fallow	.0000
Oats	.0000
Barley	.0000
Blank	.0000

MONTHS IN WHICH THE FOLLOWING TRANSACTIONS AREPERFORMED

BUSINESS ACTIVITY	Spring Wheat	Fallow	Oats	Barley	Blank
Crop placed in loan					
Crop taken out of regular loan					
PIK certificates sold					
CRP payments received					
Marketing loan repaid					
Crop insurance premiums paid	September	September	September	September	September
Crop insurance indemnities pd	October	October	October	October	October

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CASH FLOW STATEMENT FOR 1991

CASH AVAILABLE	January	February	March	April	May	June	July	August	September	October	November	December
Beginning Cash	0.	100.	0.	100.	0.	0.	0.	0.	0.	0.	0.	0.
Milk and Livestock Prod	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Crop receipts	3551.	0.	29596.	2368.	0.	0.	3551.	0.	0.	2368.	0.	76949.
Cull Livestock Sales	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Direct Government Paymt	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Direct Government Loans	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Other Government Paymts	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Miscellaneous Income	0.	0.	0.	0.	0.	0.	0.	0.	0.	18939.	0.	0.
TOTAL AVAILABLE CASH	3551.	100.	29596.	2468.	0.	0.	3551.	0.	0.	21307.	0.	76949.
CASH REQUIRED												
Per Unit Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Feed Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Misc. Livestock Expense	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Material Costs	0.	0.	0.	0.	4080.	0.	0.	0.	0.	0.	0.	0.
Chemical Costs	0.	0.	8750.	10500.	0.	7824.	7526.	0.	0.	0.	5310.	5690.
Fuel Costs	0.	846.	976.	897.	1138.	30.	32.	0.	0.	0.	655.	1665.
Labor Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Insurance Premiums	0.	0.	0.	0.	0.	0.	0.	0.	7864.	9212.	0.	0.
Repair Costs	0.	338.	390.	564.	1258.	65.	70.	0.	0.	0.	7392.	3605.
Equipment Lease Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Equipment Down Payment	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Land Cash Rent Costs	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Net Cash Withdrawals	3006.	3006.	3006.	3006.	3006.	3006.	3006.	3006.	3006.	3006.	3006.	3006.
Misc. Crop Expenses	100.	200.	275.	200.	100.	100.	100.	100.	100.	100.	100.	100.
Loan payments:												
Intermediate	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Long-term	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	4475.
Government Loans	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Tax payments:												
Federal income	0.	0.	8800.	0.	0.	8800.	0.	0.	8800.	0.	0.	8800.
State income	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.
Local prop[illegible]	0.	0.	0.	0.	0.	0.	0.	0.	0.	0.	1872.	0.
Self-employment	0.	0.	275.	0.	0.	275.	0.	0.	275.	0.	0.	275.
TOTAL REQUIREMENTS	3106.	4390.	22472.	15167.	9582.	19300.	10734.	3106.	20044.	12318.	18336.	27615.
TOTAL AVAILABLE CASH LESS TOTAL REQUIREMENTS	446.	-4290.	7124.	-12699.	-9582.	-19300.	-7182.	-3106.	-20044.	8989.	-18336.	49334.
PLUS: Cash from savings	0.	4290.	0.	12699.	734.	0.	0.	0.	0.	0.	0.	0.
NET CASH POSITION	446.	0.	7124.	0.	-8848.	-19300.	-7182.	-3106.	-20044.	8989.	-18336.	49334.
LESS: Cash added to savings	346.	0.	7024.	0.	0.	0.	0.	0.	0.	0.	0.	0.
LESS: Cash used to reduce operating loan	0.	0.	0.	0.	0.	0.	0.	0.	0.	8989.	0.	49334.
ADD: Transfer to operating loan	0.	0.	0.	0.	8848.	19300.	7182.	3106.	20044.	0.	18336.	0.
ENDING CASH ON HAND	100.	0.	100.	0.	0.	0.	0.	0.	0.	0.	0.	0.
ENDING STATUS (PRINCIPAL + INTEREST)												
Savings	10448.	6241.	13363.	734.	0.	0.	0.	0.	0.	0.	0.	10000.
Operating loan	0.	0.	0.	0.	8904.	28451.	36061.	39668.	60375.	52131.	71204.	22571.

PARTNERSHIP INCOME STATEMENT FOR EACH YEAR

	1991
CASH FARM INCOME	
Crop Receipts	118383.
Milk and Livestock Receipts	0.
Direct Government Payments	0.
Crop Insurance Indemnities	18939.
Direct Government Loans	0.
Less: Repayment of Goverment Loans	0.
Other Farm Income	0.
Savings Interest	356.
Other Government Payments	0.
TOTAL CASH RECEIPTS	137678.
CASH FARM EXPENSES	
Per Unit	0.
Materials	4080.
Chemicals	44800.
Fuel	6239.
Labor	0.
Insurance Premiums	17076.
Feed Purchases	0.
Misc. Livestock Expenses	0.
Equipment Repair	13683.
Equipment Lease	0.
Cash Rent	0.
Interest:	
Operating Loan	4082.
Equipment and Livestock	0.
Land and Buildings	2250.
Other	0.
Property Taxes	1872.
Misc. Crop Expenses	1575.
TOTAL CASH EXPENSES	95658.
NET CASH FARM INCOME	43221.
+ Ending crop inventories	0.
+ Change in value of crops in ground	0.
- Economic depreciation	
Equipment	19251.
Long term assets	356.
= NET FARM INCOME	23614.
- Federal income tax	9561.
- Social security	536.
- All state taxes	0.
= NET INCOME AFTER TAXES (NIAT)	13517.
+ Land capital gains	0.
= NIAT AND CAPITAL GAINS	13517.
- Net family withdrawals	36068.
+ Change in nonfarm net worth	0.
= CHANGE IN TOTAL NET WORTH	-22551.

TAX INCOME STATEMENT FOR EACH YEAR

	1991
CALCULATION OF BUSINESS TAXABLE INCOME:	
Net cash farm income	43221.
- Depreciation:	
Equipment	12044.
Buildings	2000.
Section 179 expensing	0.
- Tax-deductable living expenses	8601.
Farm income transferred to individu	34020.
Soc Security tax for partner #1	268.
Soc Security tax for partner #2	268.
Family allowance payments	0.

INCOME TAX STATEMENTS FOR PARTNERS

PARTNER #1:	
Share of farm taxable income	17010.
+ Off-farm income	0.
- Carryover net operating loss	0.
- Charitable contributions	550.
- Income equalisation deposits	-5000.
Taxable income	21460.
Federal income tax	4780.
Medicare Levy	268.
Total deposits in income equal.	0.
Average income tax rate	.223

PARTNER #2:	
Share of farm taxable income	17010.
+ Off-farm income	0.
- Carryover net operating loss	0.
- Charitable contributions	550.
- Income equalisation deposits	-5000.
Taxable income	21460.
Federal income tax	4780.
Medicare Levy	268.
Total deposits in income equal.	0.
Average income tax rate	.223

MARKET VALUE BALANCE SHEET

	INITIAL	1991
ASSETS:		
Ending cash on hand	0.	0.
Ending cash in savings	10000.	0.
Ending crop inventories	0.	0.
Value of crop in ground	0.	0.
Market value of machinery	172918.	153667.
Market value of land	520000.	520000.
Market value of residence	15000.	14644.
Market value of buildings	0.	0.
Mkt. value of off-farm invest.	10000.	0.
TOTAL VALUE OF ASSETS	727918.	688311.
LIABILITIES:		
Outstanding operating loan	0.	22571.
Accrued taxes		
-Federal	0.	-22439.
-State	0.	0.
-Self-employment	0.	-464.
Outstanding Government loan	0.	0.
Machinery debt	0.	0.
Land and buildings debt	15000.	12775.
TOTAL LIABILITIES	15000.	12444.
EQUITY	712918.	675867.
EQUITY PLUS LIABILITIES	727918.	688311.

National Farmers Union - January, 1992

"The Economic Policies

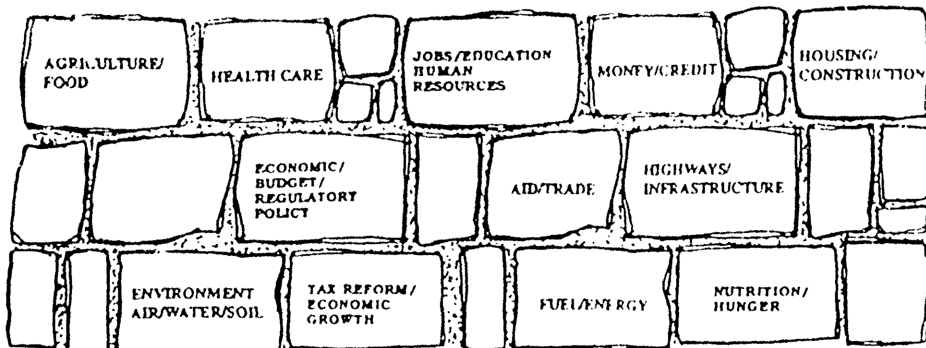
Which Have Caused

This Recession

Will Not Cure It!"

— Leland H. Swenson,
President, National Farmers Union

To be effective, any economic recovery plan must involve and revitalize our foundation sectors and industries.



On January 23rd, the National Farmers Union announced an "Economic Recovery Package" that provides a blueprint for stimulating America's sputtering economy.

Although the Farmers Union's major objective has always been to better the quality of life of rural Americans, we recognize that the state of the U.S. economy today affects us all.

Consumers whose buying power erodes cannot purchase our products; the need for health care reform and an energy strategy is not limited to a single sector of the economy; and, the scourge of hunger and homelessness in our country should be a concern to all Americans.

Our package begins with farm policy reforms since farming is the basis of sustenance, wealth creation and income production in our country. But, it doesn't stop there. It is the first definitive, broad-based package that has been developed by anyone. We want to make it the template for policy-makers and candidates to use in their search for solutions this year.

NATIONAL FARMERS UNION

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National Farmers Union January 23, 1992

Executive Summary

Recommendations for a 1992

Economic Recovery Package:

Revitalizing U.S.

Foundation Industries

Agriculture/Food

a. A value per unit of production should be set to assure a profitable return for the producer and to generate wealth creation for the community.

b. Agricultural policy should seek a balance between assuring a profitable return largely from the market-place, with supplementation of farm income, if needed, through deficiency payments

c. Target prices for program crops should be indexed to the farm parity formula or other indicators of farming costs.

d. Loan rates for program crops should be adjusted upwards to hold down the potential exposure to the cost of payment programs.

e. The dairy support level should be set at not less than $13.50 per hundred pounds in 1992, with provision for an inventory-management program or voluntary diversion program.

f. The federal milk marketing order program should be retained. Steps should be taken over a period of years to convert the existing 42 market orders into a lesser number of regional orders.

Health Care

NFU RECOMMENDS:

1. Farmers Union urges that farmers and other self-employed persons be allowed a full tax deduction for premiums paid for health insurance.
2. A tax deduction should also be allowed for the co-pay portion and deductible portion of health insurance for all Americans.
3. NFU urges immediate rural/urban equalization of Medicare reimbursement to hospitals and doctors.
4. NFU urges the Congress and the Administration to approve a universal health care program providing health service access to all Americans at an affordable cost.

Tax Policy, Economic Growth

NFU RECOMMENDS:

Farmers Union urges that steps be taken to increase the progressivity of the federal income tax by creating additional brackets at the higher levels.

Consideration should be given to establishment of a tax deferral incentive for farmers and ranchers who sell their land to a beginning farmer for operation as an independent unit.

Farmers Union favors restoration of income averaging for farmers and permission for all Americans to be allowed tax deductions for investment up to $2,000 annually in an authorized individual retirement account.

Farmers Union recommends the adoption of a transfer tax, imposed on the value of publicly-traded stocks or commodity futures contracts.

Jobs and Education

NFU RECOMMENDS:

There is a need to increase funding for education at all levels, including the Senior Community Service Employment Program and the Job Training Partnership Act.

For America to be competitive, higher education must now be made universally available to all who can benefit from it.

NFU urges a commitment to a long-term public works program to retrain and employ people throughout the United States.

Jobless pay should continue as long as declared recessionary conditions exist, and certainly not less than 52 weeks.

Food Aid/Trade

NFU RECOMMENDS:

Farmers Union believes that while overt export dumping of farm products should be discouraged, export credits and other incentives may be necessary as long as other exporting nations use them aggressively.

Currently, the U.S. Export Enhancement Program (EEP) is limited by statute to program crops and dairy animals. Legislation would be needed to authorize use of the EEP system for value-added exports.

The Dunkel package for settlement of the Uruguay Round should be rejected.

Negotiations of a North American Free Trade Agreement should be delayed until full environmental and economic impact statements have been published and widely debated.

Energy

NFU RECOMMENDS:

The U.S. needs a comprehensive national energy policy, designed to achieve a reasonable level of self-sufficiency. Such a policy should be developed to encourage broad-based development measures for a variety of energy supplies to reduce dependence on imported oil.

Various renewable sources of energy should be developed, including alcohol from all sources, wind, solar and hydro power.

NFU urges the development of our natural resources, such as natural gas and coal gasification, and continued emphasis on conservation measures.

NFU urges the study of the conversion of closed military facilities to energy development sites.

Hunger/Nutrition

NFU RECOMMENDS:

Budget allocations for federal nutrition programs should be increased to serve the obvious, demonstrated needs.

Money and Credit

NFU RECOMMENDS:

Farmers Union urges the establishment of a floating cap on interest rates for consumer credit, credit cards and other loans. For example, interest rates could be capped at three percentage points above the cost of money.

In regard to the Agricultural credit situation, Farmers Union urges that the Farmers Home Administration's guaranteed loan program be simplified, that FmHA rules and regulations be revised to better serve the needs of farmers who lack other financing, that direct lending be restored for all farmer loans.

The debt repayment ability of agriculture will remain weak as long as federal agricultural support programs fail to enhance returns to farmers. For those farm borrowers with troubled loans, resulting from causes beyond their control, effective debt restructuring may be required.

Farmers Union strongly urges the continuation and ample funding of programs of the Small Business Administration.

Environmental Protection

The protection of our groundwater resources is critical not only to continuing farm operations, but as a source of drinking water for rural residents. Our groundwater must be protected from being contaminated in the first place and quickly cleaned up when pollution does occur.

Crash efforts should be taken to test and re-register pesticides and other potentially toxic chemicals.

Major efforts should be made to clean up hazardous waste sites.

Monitoring and regulation of landfills and city wastes should be intensified and safeguards should be taken against air or water pollution from huge confinement systems of dairy, meat or poultry production.

Housing/Homelessness

NFU RECOMMENDS:

Congress should increase provision for housing assistance through the Housing and Urban Development (HUD) agency in urban areas and through Farmers Home Administration for rural areas. This would respond to obvious needs and stimulate economic demand in home building and home furnishings.

The program should include allocation of units in rural areas since substandard housing there is a glaring problem.

The FmHA Section 504 program of loans and grants for repair and weatherization of homes of rural, low-income elderly homeowners should be continued and expanded.

Highways/Infrastructure

NFU RECOMMENDS:

Congress must take effective action to assure that necessary transportation and infrastructure facilities are maintained in rural as well as urban communities.

Federal, state and local support must provide an integrated system to serve America's farmers and rural residents.

Economic, Regulatory, Budget Policy

NFU RECOMMENDS:

Farmers Union regards Gramm/Rudman as a failure. Gramm/Rudman II has not worked any better. Now we have the Budget Summit Package of 1990 and are faced with horrendously rising deficits. It is time to get rid of these tools which have not worked and have made our problems worse.

Preferably, Gramm/Rudman and the 1990 OBRA Act should be repealed, but at least Budget Summit provisions should be waived, so that Congress can provide sufficient funding for measures to lead immediately to a viable economy.

The executive and legislative branches should fully carry out the directives of the Full Employment and Balanced Growth Act of 1978.

Ten years of Executive Branch indifference to concentration in the livestock and grain markets and in the economy generally, together with massive foreign take-overs of American businesses, and disastrous deregulation of banking and airline industries, make it now essential to restore regulatory and antitrust policy vital to the protection of consumers, farmers and small business.

Next 15 Pages -- Fact and Philosophy of the NFU Economic Recovery Plan

The economy of the United States is in severe trouble. In January, 1992, h current recession became the longest recession since the end of Woi d .Var II. It exceeds in length the 1974-75 and 1981-82 crises.

Unemployment stands at a 6.8% level. But, if one includes those who have left the labor force and those who want to work full-time but can find only part-time work, the combined unemployment and underemployment rate is closer to 16%.

Since the Bush Administration took over in January, 1989, over two million more people are unemployed, five million more people have had to resort to Food Stamp assistance.

The economy has been stagnant for three years. The purchasing power of the American people has declined in Rural America and in the major cities.

In October, 1991, alone, these major firms have layed off workers:

American Express
Pacific Telesis
Hercules
Amoco
Raytheon
Westinghouse
Allied Signal
RJR Nabisco
Boeing
United Technology
Exxon
U.S. Shoe
Sears
Campbell's Soup
Citicorp
AT&T
IBM
Bell Atlantic
Rockwell
Time, Inc.
General Electric
Walmart
Chase Manhattan
Phelps Dodge

In order for the U.S. economy to regain vitality, national priorities must be redefined and re-ordered.

The t..p priority of the Bush Administration and the Congress must be a full-employment, full-production economy.

An Economic Recovery Package must address the needs of the American people, not serve the greed of transnational corporations.

Most of this National Farmers Union Economic Recovery Package can be carried out within the authority of existing law.

"We had to balance the budget of the American people before we could balance the budget of the federal government."
— Franklin D. Roosevelt
October, 1936

January, 1992

National Farmers Union

'92 Economic Recovery Package

Agriculture As A Vital Factor in The National Economy

Agriculture is the most important industry in wealth creation and income production in the 2,400 nonmetro counties of the nation. The agricultural complex accounts for 19% of the total employment of the nation.

There are 6 million farm-related jobs in rural counties and 14 million such jobs in metropolitan counties. Thus, 70% of the farm-related jobs are in metro areas.

The long-running agricultural recession has caused an alarming loss of jobs during the past 15 years. Almost 600,000 jobs have been lost in farming and agribusiness since 1975.

The 1990 Farm Act has weakened the economic position of farmers, reducing net farm income and eroding the farm balance sheet. Farming outlays are forecast to increase by about $3 billion in 1992, while farm income is expected to drop. Total net farm income is projected to decline by $1 billion in the 1992 production year. Farm asset and equity growth is likely to be weak and to lag significantly behind the inflation rate.

In October 1991, prices received by U.S. farmers stood at 49.61% of parity, the lowest point in 76 years of such reported data. The October, 1991 figure was 3.5 points below the poorest reading in the Great Depression.

To stop this deterioration of farming and the rural economy, National Farmers Union believes that major re-direction of U.S. farm policies will become absolutely necessary.

NFU RECOMMENDS:

a. A value per unit of production should be set to assure a profitable return for the producer and to generate wealth creation for the community.

b. Agricultural policy should seek a balance between assuring a profitable return largely from the market-place, with supplementation of farm income, if needed, through deficiency payments

c. Target prices for program crops should be indexed to the farm parity formula or other indicators of farming costs.

d. Loan rates for program crops should be adjusted upwards to hold down the potential exposure to the cost of payment programs.

e. The dairy support level should be set at not less than $13.50 per hundred pounds in 1992, with provision for an inventory-management program or voluntary diversion program.

f. The federal milk marketing order program should be retained. Steps should be taken over a period of years to convert the existing 42 market orders into a lesser number of regional orders.

"The economy has been weak for three years, reflecting structuring problems of the 1980's and we're paying for it now. You can't keep the economy going forever by building empty office buildings and Patriot missiles."

Economist Lawrence Chimerine

National Farmers Union

January, 1992

'92 Economic Recovery Package

Paying Too Much for Inadequate Health Care

More than 37 million Americans are without any health care protection while medical and hospital care costs advance at two to three times the inflation rate.

Loss of jobs often results in loss of health insurance.

An alarming number of the 2,700 community hospitals in rural America are under stress because of inadequate Medicare reimbursement rates. There is a payment differential of 25% between rural and urban hospitals. Underfunding of Medicaid services by federal and state governments has affected low-income people who most need these services. Many persons find it difficult to reach doctors who will accept Medicaid patients.

Cost containment continues to be a crucial need. President Jimmy Carter declared that "If we fail as a nation to restrain health care inflation, it will be because we lack the strength and purpose to do so, not because we lack the means.

President Nixon imposed effective health care cost controls in 1972, but then removed them under pressure from the industry.

NFU RECOMMENDS:

1. Farmers Union urges that farmers and other self-employed persons be allowed a full tax deduction for premiums paid for health insurance.
2. A tax deduction should also be allowed for the co-pay portion and deductible portion of health insurance for all Americans.
3. NFU urges immediate rural/urban equalization of Medicare reimbursement to hospitals and doctors.
4. NFU urges the Congress and the Administration to approve a universal health care program providing health service access to all Americans at an affordable cost.

"I don't think it's possible to say that we are a civilized nation when so many of our people do not have long-term care, do not have health insurance."
—U.S. Senator Jay Rockefeller,
Chairman, U.S. Commission on Comprehensive Health Care

January, 1992

National Farmers Union

'92 Economic Recovery Package

Tax Policy and Economic Growth

Our federal income tax system was wisely founded on the principle of equity and progressivity.

Stated simply, the intent was that persons in similar circumstances with similar incomes and assets should be taxed alike, and those who have more should pay higher rates than those who have less.

Progressive tax rates ensure that the burden of taxation will vary with ability to pay.

However, the progressivity of our tax system has been damaged severely by the tax reform legislation of the 1980's. The share of federal revenues paid by the wealthy has dwindled while the tax burden on the middle-income taxpayer has increased.

While the income tax has become less progressive, the Social Security tax system has continued to be very regressive in impact. The net effect has been to aggravate an already heavy burden upon the middle-income taxpayers

Not only have the wealthy been given substantial tax concessions, but many high-income individuals pay no income tax at all.

National Farmers Union believes that a reduction of capital gains tax rates would be a windfall principally for high-income taxpayers. The top 2% of the income taxpayers get two-thirds of the benefits of capital gains concessions.

NFU RECOMMENDS:

Farmers Union urges that steps be taken to increase the progressivity of the federal income tax by creating additional brackets at the higher levels.

Consideration should be given to establishment of a tax deferral incentive for farmers and ranchers who sell their land to a beginning farmer for operation as an independent unit.

Farmers Union favors restoration of income averaging for farmers and permission for all Americans to be allowed tax deductions for investment up to $2,000 annually in an authorized individual retirement account.

Farmers Union recommends the adoption of a transfer tax, imposed on the value of publicly-traded stocks or commodity futures contracts.

"The last decade has been the most anti-family decade since the Great Depression."

— Senator Lloyd Bentsen, Chairman, Senate Finance Committee

January, 1992

National Farmers Union

'92 Economic Recovery Package

Jobs, Education and Human Resources

In 1988, when he was a candidate for the presidency, George Bush pledged that his economic policies would create 30 million new jobs in the next 8 years.

If his program was on target, the Bush policies should have created 11.4 million jobs during this first three years.

How has he done? By the third quarter of 1991 259,000 new jobs had been created. It is not easy to create new jobs when nothing is done to strengthen foundation industries, such as agriculture, housing, construction, and energy.

With high unemployment and widespread lay-offs, it is vital that important emphasis be given to retraining of workers for useful and constructive work.

The nation has tremendous needs in infrastructural improvements — roads, bridges, hospitals, schools, parks and other public facilities.

In the private sector, there will be needs for workers in the energy and environmental sectors.

NFU RECOMMENDS:

There is a need to increase funding for education at all levels, including the Senior Community Service Employment Program and the Job Training Partnership Act.

For America to be competitive, higher education must now be made universally available to all who can benefit from it.

NFU urges a commitment to a long-term public works program to retrain and employ people throughout the United States.

Jobless pay should continue as long as declared recessionary conditions exist, and certainly not less than 52 weeks.

"We can now safely abandon the basic doctrine of the 1980's that if the horse be fed enough oats, some will pass through to the road for the sparrows."
Economist John Kenneth Galbraith, October, 1991

National Farmers Union January, 1992

'92 Economic Recovery Package

Food Aid and Trade

The experience with Public Law 480, the Food for Peace program, has been that it has stimulated the economic development of the recipient countries and enabled many of them to emerge into the economic mainstream.

Seven of the ten leading cash buyers of U.S. farm products today are former recipients of the Food for Peace program.

Food needs are acute in several parts of the world currently, in some instances because of crop failure from natural causes. The largest challenge has occurred due to the disintegration of the erstwhile Soviet Union. The 1991 crops in the USSR are well below the good crops of a year earlier. Transportation and storage problems are also serious.

Use of CCC stocks in humanitarian feeding programs helps reduce government-held reserves and exerts some desirable upward thrust to farm market prices.

If the Uruguay Round of trade negotiations under the General Agreement on Tariffs and Trade (GATT) results in a trade pact which moves towards free-market pricing of farm products, this will be a severe blow to people of the less developed countries. Free market pricing will be most damaging to farmers of the developing world, and, of course, will harm producers everywhere.

A harmful GATT pact will aggravate hunger problems in the world and reduce the food-buying power of people most afflicted by poverty.

NFU RECOMMENDS:

Farmers Union believes that while overt export dumping of farm products should be discouraged, export credits and other incentives may be necessary as long as other exporting nations use them aggressively.

Currently, the U.S. Export Enhancement Program (EEP) is limited by statute to program crops and dairy animals. Legislation would be needed to authorize use of the EEP system for value-added exports.

The Dunkel package for settlement of the Uruguay Round should be rejected.

Negotiations of a North American Free Trade Agreement should be delayed until full environmental and economic impact statements have been published and widely debated.

"From 1982 to 1991, U.S. Presidents have requested $5.839 trillion in appropriations. The Congress has authorized $5.830 trillion, $9 billion less than what Presidents Reagan and Bush have requested."
— Rep. Leon Panetta, Chairman, House Budget Committee

National Farmers Union January, 1992

'92 Economic Recovery Package

Supply and Price Concerns About Energy

Energy shocks seem to be felt more strongly in agriculture than in other sectors. Global studies of energy supplies and prices in agriculture indicate that the cut-off of energy supplies has usually doubled energy costs for farm producers in the U.S. and elsewhere.

In normal times, direct energy costs account for 3.5% of total farm production outlays in the United States, while rising as high as 7.4% of operating costs when supplies are cut off for whatever reason.

NFU RECOMMENDS:

The U.S. needs a comprehensive national energy policy, designed to achieve a reasonable level of self-sufficiency. Such a policy should be developed to encourage broad-based development measures for a variety of energy supplies to reduce dependence on imported oil.

Various renewable sources of energy should be developed, including alcohol from all sources, wind, solar and hydro power.

NFU urges the development of our natural resources, such as natural gas and coal gasification, and continued emphasis on conservation measures.

NFU urges the study of the conversion of closed military facilities to energy development sites.

"We need a new economic plan for this country, a new economic plan for America, one that concentrates on the real needs of our people. That is what this country needs."

— U.S. Senator Donald Riegle, Chairman, Senate Banking Committee

National Farmers Union

January, 1992

'92 Economic Recovery Package

Hunger in America is Unacceptable

Food Stamp participation had risen to 24 million persons in late 1991, with a 400,000 increase in just one month alone. Just over 50% of the participants are children, 8% are elderly.

Food stamp participation had risen to 22.4 million persons in June 1991, equal to the level during the 1981 recession.

National School Lunch Program participation in 92,500 schools, as of July 1, 1991, was 24.6 million students. Children receiving free or reduced-price lunches equalled 50.3% of the total participants, the highest level in six years.

Even in relatively wealthy urban counties, large numbers of students from middle-income families have recently been qualifying for reduced or free lunch services. In December, 1991, in Fairfax county, Virginia, there has been a 63% increase in the number of students qualifying for free school lunches. Increases of 33% were reported in Prince William County, 22% in Arlington county, and 20% in Prince Georges County.

Some 4.5 million children participated in the school breakfast program in July, 1991, a record level. About 43% required free or reduced-price breakfasts.

Nearly 5 million women and children benefited from the Special Supplemental Food Program for Women, Infants and Children (WIC), as of July 1, 1991. This is a little more than half of the eligible persons. Making up the participants are 1.1 million women, 1.5 million infants and 2.1 million children.

NFU RECOMMENDS:

Budget allocations for federal nutrition programs should be increased to serve the obvious, demonstrated needs.

"One of the most sobering facts concerning poverty and hunger in America is that the most affected are children."

— Bread for the World, 1991 Report

National Farmers Union

January, 1992

'92 Economic Recovery Package

The Money and Credit Hemorrhage

A U.S. economic recovery is being impeded by interest rates which remain too high even though the Federal Reserve has cut the discount rate several times and because banks are reluctant to lend money in the existing business context.

Interest rate outlays are the second highest business expense of farmers.

National Farmers Union believes that the Treasury Department or the Federal Reserve should allocate credit to productive enterprises and deny loans to highly-questionable speculative ventures such as junk-bond financing of take-overs and mergers.

NFU RECOMMENDS:

Farmers Union urges the establishment of a floating cap on interest rates for consumer credit, credit cards and other loans. For example, interest rates could be capped at three percentage points above the cost of money.

In regard to the Agricultural credit situation, Farmers Union urges that the Farmers Home Administration's guaranteed loan program be simplified, that FmHA rules and regulations be revised to better serve the needs of farmers who lack other financing, that direct lending be restored for all farmer loans.

The debt repayment ability of agriculture will remain weak as long as federal agricultural support programs fail to enhance returns to farmers. For those farm borrowers with troubled loans, resulting from causes beyond their control, effective debt restructuring may be required.

Farmers Union strongly urges the continuation and ample funding of programs of the Small Business Administration.

"Short-run help for the economy must come principally from lower interest rates . . . However, the FED's action to date still have long-term interest rates at historically quite high levels."

—Lyle Gramley, chief economist, Mortgage Bankers of America

January, 1992

National Farmers Union

'92 Economic Recovery Package

Environmental Protection

National Farmers Union believes that conservation and protection of our air, soil and water resources is vital to a sustainable system of agriculture.

NFU RECOMMENDS:

The protection of our groundwater resources is critical not only to continuing farm operations, but as a source of drinking water for rural residents. Our groundwater must be protected from being contaminated in the first place and quickly cleaned up when pollution does occur.

Crash efforts should be taken to test and re-register pesticides and other potentially toxic chemicals.

Major efforts should be made to clean up hazardous waste sites.

Monitoring and regulation of landfills and city wastes should be intensified and safeguards should be taken against air or water pollution from huge confinement systems of dairy, meat or poultry production.

"FDA's pesticide monitoring program provides limited protection against public exposure to illegal residues in food. FDA annually samples less than 1% of approximately one million food shipments."
— General Accounting Office report, Pesticides in Imported Foods.

National Farmers Union January, 1992

'92 Economic Recovery Package

Housing and Homelessness

The cost of shelter in the United States has virtually tripled since 1975. The cost of a new home has gone well beyond the means of most young families.

The average monthly mortgage payment now takes more than 30% of family income compared with 24% fifteen years ago. The average outlay for rent followed a similar pattern.

Federal housing assistance has dropped from $25.2 billion in 1985 to $16.1 billion in 1990.

Housing starts dropped from 1.8 million in 1986 to 1.1 million in 1990.

As a result, homelessness grew dramatically even in what was termed "the longest peacetime expansion in history" in the 1980's. In major metro areas, 50% to 75% of the homeless are families with children. In 1984, homelessness was estimated at 300,000 --- today it is put at 3,000,000.

NFU RECOMMENDS:

Congress should increase provision for housing assistance through the Housing and Urban Development (HUD) agency in urban areas and through Farmers Home Administration for rural areas. This would respond to obvious needs and stimulate economic demand in home building and home furnishings.

The program should include allocation of units in rural areas since substandard housing there is a glaring problem.

The FmHA Section 504 program of loans and grants for repair and weatherization of homes of rural, low-income elderly homeowners should be continued and expanded.

Home is where the heart is and where much of family income goes.

January, 1992

National Farmers Union

'92 Economic Recovery Package

Highways and Infrastructure

Public infrastructure is the broad term for public facilities in highway, air or water transportation or water supplies.

In a sense, infrastructure could be said to be the life-support system of the community and nation.

Since 1981, the federal government has systematically attempted to reduce its involvement in financing of infrastructure improvements. The Reagan administration resisted releasing funds from the federal Highway Trust Fund, allowing conditions on highways and bridges deteriorate. The tragedy is that the longer that necessary repairs and replacement are delayed, the costlier the program will be.

In consideration of the 1991 Surface Transportation Act, the Bush Administration tried persistently to reduce the federal share and to shift the burden significantly to the state and local level. At the same time, rural areas found themselves with a low priority. About $31.5 billion will be diverted from the Highway Trust Fund to be spent on urban mass transit.

Nevertheless, the $151 billion, six-year measure will provide some spur to economic activity and sustain 600,000 existing or new jobs.

NFU RECOMMENDS:

Congress must take effective action to assure that necessary transportation and infrastructure facilities are maintained in rural as well as urban communities.

Federal, state and local support must provide an integrated system to serve America's farmers and rural residents.

"Yes, there are layoffs and many families are having a rough go of it, and the American people want action. And action is what they'll get. And I want every American to know that getting the economy back on track is my No.1 priority."
— President George Bush

National Farmers Union January, 1992

'92 Economic Recovery Package

Economic, Regulatory, Budget Policy

Each year the federal budget deficit situation becomes worse. Gramm/Rudman was supposed to balance the federal budget withir fi· e years. Gramm/Rudman II set another target date for a balanced budget. Now, w· have the 1990 budget deficit summit and we are headed for successively escalati. g aeficits.

In eight years, President Reagan was responsible for more deficits than all his predecessors in 200 years. He came into office with $914 billion in federal debt — he left office with $2.6 trillion in debt.

President Reagan never submitted a balanced budget to the Congress. During his eight years, Congress always appropriated less than the White House had recommended.

The real dispute between the White House and the Congress has been in regard to priorities, rather than sheer spending totals.

It seems logical to conclude that the Reagan and Bush Administrations have never been serious about a balanced federal budget. The federal deficits have been convenient excuses to keep the pressure on Congress to cut appropriations which the White House despised.

NFU RECOMMENDS:

Farmers Union regards Gramm/Rudman as a failure. Gramm/Rudman II has not worked any better. Now we have the Budget Summit Package of 1990 and are faced with horrendously rising deficits. It is time to get rid of these tools which have not worked and have made our problems worse.

Preferably, Gramm/Rudman and the 1990 OBRA Act should be repealed, but at least Budget Summit provisions should be waived, so that Congress can provide sufficient funding for measures to lead immediately to a viable economy.

The executive and legislative branches should fully carry out the directives of the Full Employment and Balanced Growth Act of 1978.

Ten years of Executive Branch indifference to concentration in the livestock and grain markets and in the economy generally, together with massive foreign take-overs of American businesses, and disastrous deregulation of banking and airline industries, make it now essential to restore regulatory and antitrust policy vital to the protection of consumers, farmers and small business.

"We should abandon the 1990 budget summit agreement to take into account the recent economic turndown." —U.S. Senator Robert Kasten (R), Wisconsin

"The deficit summit of October, 1990 has the country in a straitjacket." — U.S. Senator Bill Bradley (D), New Jersey

January, 1992

National Farmers Union

'92 Economic Recovery Package

THE FULL EMPLOYMENT AND BALANCED GROWTH ACT AS THE BASIS FOR AN ECONOMIC RECOVERY PACKAGE

Public Law 95-523, the Full Employment And Balanced Growth Act of 1978, provides needed authority for planning and implementation of a full-employment, full-production, full farm parity economy.

The measure, sponsored by Senator Hubert H. Humphrey and Rep. Augustus Hawkins, was sponsored "to translate into practical reality the right of all Americans who are able, willing, and seeking to work, to full employment for useful paid employment at fair rates of compensation, production, and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and reasonable price stability; to require the President each year to set forth explicit short-term and medium-term economic goals; to achieve a better integration of general and structural economic policies; and to improve the coordination of economic policy-making within the federal government."

To fulfill these objectives, the law establishes goals and a timetable for achieving an unemployment of not more 3% for adults and 4% for the entire civilian labor force aged 16 and over.

Further, the Act sets a goal of reducing the national inflation rate to 3%.

The Act directs the President each year to set priority policies and programs in his budget message, which include, among others:

a. Development of energy sources and supplies, transportation needs and environmental improvements.

b. Attention to the needs of small business.

c. A comprehensive national agricultural policy that assures farm and ranch income at full parity levels, together with renewed commitment to conservation of rural land and water resources.

d. Attention to the availability and quality of health care, education and work training services.

The Act requires the cooperation of the agencies of the Executive Branch, the Federal Reserve, the office of Management and Budget, the Commerce and Treasury Departments, the President's Council of Economic Advisers, the Joint Economic Committee, the House and Senate Budget committees and the committees of Congress having jurisdiction in economic matters.

NFU RECOMMENDS:

The executive and legislative branches should fully comply with the mandates of the Full Employment and Balanced Growth Act of 1978.

"This recession is a wholly predictable response to the speculative extravagances and insanities of the 1980's. The hard fact of this recession is that no one knows when it will end."

Economist John Kenneth Galbraith, October 16, 1991

Some Committees Dealing with Economic Policy

Joint Economic Committee

MEMBERS

Chairman.—Paul S. Sarbanes, Senator from Maryland.
Vice Chairman.—Lee H. Hamilton, Representative from Indiana.

SENATE

Lloyd Bentsen, of Texas.
Edward M. Kennedy, of Massachusetts.
Jeff Bingaman, of New Mexico.
Albert Gore, Jr., of Tennessee.
Richard H. Bryan, of Nevada.
William V. Roth, Jr., of Delaware.
Steve Symms, of Idaho.
Connie Mack, of Florida.
Robert C. Smith, of New Hampshire.

HOUSE

David R. Obey, of Wisconsin.
James H. Scheuer, of New York.
Fortney Pete Stark, of California.
Stephen J. Solarz, of New York.
Kweisi Mfume, of Maryland.
Richard K. Armey, of Texas.
Chalmers P. Wylie, of Ohio.
Olympia J. Snowe, of Maine.
Hamilton Fish, Jr., of New York.

Senate Finance

(Suite SD-205, phone 224-4515, meets second and fourth Tuesdays of each month)

Lloyd Bentsen, of Texas.
Daniel Patrick Moynihan, of New York.
Max Baucus, of Montana.
David L. Boren, of Oklahoma.
Bill Bradley, of New Jersey.
George J. Mitchell, of Maine.
David Pryor, of Arkansas.
Donald W. Riegle, Jr., of Michigan.
John D. Rockefeller IV, of West Virginia.
Thomas A. Daschle, of South Dakota.
John B. Breaux, of Louisiana.

Bob Packwood, of Oregon.
Robert Dole, of Kansas.
William V. Roth, Jr., of Delaware.
John C. Danforth, of Missouri.
John H. Chafee, of Rhode Island.
Dave Durenberger, of Minnesota.
Steve Symms, of Idaho.
Charles E. Grassley, of Iowa.

House Ways & Means

(1102 LHOB, phone 225-3625, meets first Wednesday)

Ratio: 23/13

Dan Rostenkowski, of Illinois.
Sam Gibbons, of Florida.
J.J. Pickle, of Texas.
Charles B. Rangel, of New York.
Fortney Pete Stark, of California.
Andrew Jacobs, Jr., of Indiana.
Harold E. Ford, of Tennessee.
Ed Jenkins, of Georgia.
Thomas J. Downey, of New York.
Frank J. Guarini, of New Jersey.
Marty Russo, of Illinois.
Donald J. Pease, of Ohio.
Robert T. Matsui, of California.
Beryl Anthony, Jr., of Arkansas.
Byron L. Dorgan, of North Dakota.
Barbara B. Kennelly, of Connecticut.
Brian J. Donnelly, of Massachusetts.
William J. Coyne, of Pennsylvania.
Michael A. Andrews, of Texas.
Sander M. Levin, of Michigan.
Jim Moody, of Wisconsin.
Benjamin L. Cardin, of Maryland.
Jim McDermott, of Washington.

Bill Archer, of Texas.
Guy Vander Jagt, of Michigan.
Philip M. Crane, of Illinois.
Richard T. Schulze, of Pennsylvania.
Willis D. Gradison, Jr., of Ohio.
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Raymond J. McGrath, of New York.
Rod Chandler, of Washington.
E. Clay Shaw, Jr., of Florida.
Don Sundquist, of Tennessee.
Nancy L. Johnson, of Connecticut.
Jim Bunning, of Kentucky.
Fred Grandy, of Iowa.

Some Committees Dealing with Economic Policy

Senate Banking

Banking, Housing, and Urban Affairs

(Suite SD-534, phone 224-7391, meets last Tuesday of each month)

Donald W. Riegle, Jr., of Michigan.
Alan Cranston, of California.
Paul S. Sarbanes, of Maryland.
Christopher J. Dodd, of Connecticut.
Alan J. Dixon, of Illinois.
Jim Sasser, of Tennessee.
Terry Sanford, of North Carolina.
Richard C. Shelby, of Alabama.
Bob Graham, of Florida.
Timothy E. Wirth, of Colorado.
John F. Kerry, of Massachusetts.
Richard H. Bryan, of Nevada.

Jake Garn, of Utah.
Alfonse M. D'Amato, of New York.
Phil Gramm, of Texas.
Christopher S. Bond, of Missouri.
Connie Mack, of Florida.
William V. Roth, Jr., of Delaware.
Pete V. Domenici, of New Mexico.
Nancy Landon Kassebaum, of Kansas.

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House Banking

Henry B. Gonzalez, of Texas.
Frank Annunzio, of Illinois.
Stephen L. Neal, of North Carolina.
Carroll Hubbard, Jr., of Kentucky.
John J. LaFalce, of New York.
Mary Rose Oakar, of Ohio.
Bruce F. Vento, of Minnesota.
Doug Barnard, Jr., of Georgia.
Charles E. Schumer, of New York.
Barney Frank, of Massachusetts.
Ben Erdreich, of Alabama.
Thomas R. Carper, of Delaware.
Esteban Edward Torres, of California.
Gerald D. Kleczka, of Wisconsin.
'aul E. Kanjorski, of Pennsylvania.
Elizabeth J. Patterson, of South Carolina.
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Floyd H. Flake, of New York.
Kweisi Mfume, of Maryland.
Peter Hoagland, of Nebraska.
Richard E. Neal, of Massachusetts.
Charles J. Luken, of Ohio.
Maxine Waters, of California.
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Bill Orton, of Utah.
Jim Bacchus, of Florida.
James P. Moran, of Virginia.
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Ted Weiss, of New York.
Jim Slattery, of Kansas.
Gary L. Ackerman, of New York.

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Jim Leach, of Iowa.
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Mel Hancock, of Missouri.
Frank D. Riggs, of California.
Jim Nussle, of Iowa.
Richard K. Armey, of Texas.
Craig Thomas, of Wyoming.

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BERNARD SANDERS, of Vermont.

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[JOINT COMMITTEE PRINT]

DESCRIPTION OF MISCELLANEOUS FARM TAX PROPOSALS (S. 710, S. 887, S. 900, S. 1045, S. 1061, S. 1130, AND S. 2202)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

OF THE

SENATE COMMITTEE ON FINANCE

ON APRIL 29, 1992

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The Subcommittee on Energy and Agricultural Taxation of the Senate Committee on Finance has scheduled a public hearing on April 29, 1992, to consider various farm tax proposals. This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and the proposals and an analysis of issues raised by the proposals.

The first part of the pamphlet provides a summary of the bills (in numerical order) that are the subject of the hearing. The second part of the pamphlet provides a description of present law and the bills and an analysis of issues raised by the bills.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of Miscellaneous Farm Tax Proposals* (JCS-10-92), April 27, 1992.

I. SUMMARY OF BILLS

A. S. 710—Senators Grassley, Dixon, Simon, and Dole

Permanent Extension of First-Time Farmer Bonds

S. 710 would permanently extend the authority of State and local governments to issue small-issue bonds for first-time farmers, which currently is scheduled to expire after June 30, 1992.

B. S. 887—Senators Jeffords, Symms, Daschle, Bumpers, Craig, and Leahy

Special Valuation of Sensitive Environmental Areas for Estate Tax Purposes

S. 887 would allow the executor of an estate to value an interest in a sensitive environmental area at its environmental use value for Federal estate tax purposes. The environmental use value would be the value of the interest in a sensitive environmental area, subject to an environment preservation easement. A sensitive environmental area would be defined as a wetlands area or other area of undeveloped natural condition or open space. An environmental preservation easement generally would be defined as a preservation easement granted for 10 years beginning from the date of death. Such easement could be granted by the decedent or executor, but would not qualify for a charitable deduction for income or estate tax purposes if granted by the latter.

S. 887 would apply to decedents dying after the date of enactment.

C. S. 900—Senators Conrad, Daschle, Burdick, Dixon, Harkin, Heflin, Kerrey, Levin and Symms

Tax Relief for Farmers Who Realize Capital Gain on the Transfer of Farm Property to Satisfy an Indebtedness

S. 900 would provide an exclusion from gross income for gain that is realized by certain farmers on the transfer of farm property in satisfaction of farm indebtedness. In addition, farmers meeting certain requirements could elect to exclude from gross income certain income from the discharge of indebtedness, subject to a lifetime limitation of $300,000.

S. 900 would apply to transfers and discharges of indebtedness occurring after December 31, 1986.

D. S. 1045—Senators Kassebaum, Dole, and Conrad

Treatment of Certain Leases to Lineal Descendants for Estate Tax Special Use Valuation Purposes

S. 1045 would provide that a cash rental of specially valued real property by a lineal descendent of the decedent to a member of the descendant's family would not result in the property failing to be treated as used in a qualified use for purposes of the special use valuation recapture tax.

S. 1045 would apply to rentals occurring, and decedents dying, after December 31, 1976.

E. S. 1061—Senators Conrad, Kassebaum, and Exon

Treatment of Certain Leases to Qualified Heirs for Estate Tax Special Use Valuation Purposes

S. 1061 would provide that a cash rental of specially valued real property by a family member receiving the property to a member of the recipient's family would not result in the property failing to be treated as used in a qualified use for purposes of the special use valuation recapture tax.

S. 1061 would apply to rentals occurring, and decedents dying, after December 31, 1976.

F. S. 1130—Senators Kasten, Shelby, and Burns

Rollover of Gain From Sale of Farm Assets into an Asset Rollover Account

S. 1130 would permit a qualified farmer to defer recognition of a limited amount of net gain from the sale of qualified farm assets to the extent the farmer contributes an amount equal to such gain to one or more asset rollover accounts ("ARAs") in the taxable year in which the sale occurs. An ARA would be an individual retirement arrangement ("IRA") that is designated at the time of establishment as an ARA. Except as provided under the bill, an ARA would be treated in the same manner as an IRA. Thus, amounts contributed to an ARA would not be includible in income until withdrawn from the ARA. However, no deduction would be allowed for contributions to an ARA, and rollover contributions to an ARA could be made only from other ARAs.

S. 1130 would apply to sales and exchanges occurring after the date of enactment.

G. S. 2202—Senator Kassebaum

Exclusion of Gain on the Sale of Farmland With an Adjoining Principal Residence

S. 2202 would modify the $125,000 lifetime exclusion of gain that applies to the sale of a principal residence by individuals who have attained age 55. Specifically, the bill would extend the exclusion to gain derived from the sale of farmland that adjoins the land on which the principal residence is located. The exclusion would only

apply to farmland which has been actively farmed by the taxpayer and which is sold with the principal residence.

S. 2202 would apply to sales and exchanges of principal residences occurring after December 31, 1991.

II. DESCRIPTION OF BILLS

A. Qualified Small-Issue Bonds for First-Time Farmers (S. 710—Senators Grassley, Dixon, Simon, and Dole)

Present Law

Interest on certain small issues of private activity bonds is excludable from gross income if at least 95 percent of the bond proceeds is to be used to finance manufacturing facilities or certain agricultural land or equipment ("qualified small-issue bonds").

Qualified small-issue bonds are bond issues having an aggregate authorized face amount of $1 million or less. Alternatively, the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, may not exceed $10 million.

Qualified small-issue bonds for agricultural land ("first-time farmer bonds") may be used only to provide financing to first-time farmers who will materially participate in the farming operation to be conducted on the financed land. Up to 25 percent of the proceeds of a first-time farmer bond issue ($250,000 lifetime maximum) may be used to finance farm equipment to be used on the financed land; however, no more than $62,500 of bond proceeds may be used to finance used farm equipment.

Qualified small-issue bonds, like certain other private activity bonds, are subject to annual State private activity bond volume limitations.

The authority to issue qualified small-issue bonds (including first-time farmer bonds) is scheduled to expire after June 30, 1992.

Explanation of the Bill

The bill would permanently extend the authority to issue first-time farmer bonds.

Effective date.—The bill (as introduced) is effective for bonds issued after December 31, 1991.[2]

Analysis

Overview

The purpose of the first-time farmer bond program is to increase the number of younger individuals who seek a livelihood in farming by reducing the financial burden of establishing an agricultural enterprise. Individual farmers and new farmers generally face

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[2] The bill was introduced before enactment of the Tax Extension Act of 1991 and does not reflect the extension of the authority to issue qualified small-issue bonds from December 31, 1991, to June 30, 1992, that was included in that Act.

higher costs of funds than do larger, more established farming businesses because of the perceived risk of the enterprises. Some analysts believe that the private market overprices the riskiness of such enterprises. Others argue that the private market does not account for the benefits, in addition to the profits earned by farmers, which accrue to the economy from the creation and maintenance of family farms. The qualified small-issue bond program is intended to address the higher cost of capital faced by small manufacturing enterprises and first-time farmers.

Efficiency of tax-exempt bonds for funds provided to individuals

As is the case generally with tax-exempt bonds, the amount of the revenue lost to the Federal Government through the issuance of first-time farmer bonds is not completely transferred to first-time farmers as an interest rate subsidy. This occurs primarily for two reasons. First, the Federal income tax has graduated marginal tax rates. Thus, $100 of interest income forgone to a taxpayer in the 31-percent bracket costs the Federal Government $31, while the same amount of interest income forgone to a taxpayer in the 28-percent bracket costs the Federal Government $28. Generally, a taxpayer will find it attractive to buy a tax-exempt security rather than an otherwise equivalent taxable security if the interest rate paid by the tax-exempt security is greater than the after-tax yield from the taxable security, r(1-t), where t is the taxpayer's marginal tax rate and r is the yield on the taxable security. Consequently, if a taxpayer in the 28-percent bracket finds it profitable to hold a tax-exempt security, a taxpayer in the 31-percent bracket will find it even more profitable. Assuming the borrower receives the loan at the tax-exempt bond rate, this conclusion implies that the Federal Government will lose more in revenue than the first-time farmer gains in reduced interest payments.

Moreover, the recipient of the loan does not receive the full spread in yields between taxable and tax-exempt securities. For example, issuers of qualified small-issue bonds are permitted to charge the borrower up to 12.5 basis points above the tax-exempt bond yield plus certain costs. This reduces the ultimate size of the interest rate subsidy received by the qualifying farmer.

The use of tax-exempt bonds to re-lend funds to individuals also creates another inefficiency which sometimes works to the ultimate borrowers' benefit and sometimes to their detriment. In some cases, first-time farmer bonds are issued as a composite of issues for several borrowers. This structure may force the ultimate borrowers to either accelerate or delay the date at which they would otherwise choose to borrow funds. When interest rates are falling, this means that borrowers who delayed their borrowing benefit from a lower interest rate than they would otherwise receive, but borrowers who accelerated their borrowing pay a higher interest rate than if they had waited. For example, interest rates on long- and short-term conventional bank loans have fallen more than 100 basis points over the past six months. If first-time farmer bonds had been issued six months ago on behalf of borrowers who otherwise would have waited until today to borrow, the effective interest subsidy available would have narrowed by 100 basis points. Of course, if in-

terest rates were rising, the effective interest subsidy would be increased.

Measuring the costs and benefits of qualified first-time farmer bonds

Measuring the costs of the first-time farmer bond program is relatively straightforward. The tax revenue foregone from investors purchasing and holding tax-exempt securities rather than taxable securities (less the tax revenue gained by the reduction in deductible business interest and depreciation expenses claimed by beneficiaries of qualified first-time farmer bonds) represent the majority of the cost of the program. In addition, the value of the inherent inefficiencies involved in tax-exempt finance, discussed above, represent costs.[3]

The benefits, on the other hand, are much harder to quantify. This is because the benefits take two broad forms. For some recipients of loans financed by qualified first-time farmer bonds the interest rate subsidy lowers their cost of obtaining capital, but does not directly alter their ability to obtain capital. That is, some recipients of the subsidy could successfully qualify for a conventional business loan at prevailing market interest rates. For these recipients of the subsidy, the benefit is the reduction in cost.

However, first-time farmer bonds may permit other borrowers to obtain capital when they would not otherwise have been able to do so, or to obtain more capital than they otherwise might have. In this case, the benefit is substantially more difficult to quantify. The benefit could be measured, in principle, by the net increase in employment and profits in the agricultural sector.

It is inappropriate to attempt to measure the benefits of the first-time farmer bond program by counting the number of qualifying farms and the payrolls of such farmers receiving tax-exempt bond-financed loans. First, employment growth in enterprises receiving these loans does not necessarily represent net employment additions to the national economy. The additional workers may simply be attracted to farming from other productive endeavors. More subtly, first-time farmers may attract some of their labor from other established businesses, which do not replace all of their lost employees.

Some analysts believe that promoting the creation of new family farms creates additional benefits not captured in the reduced interest cost to the enterprise.[4] They argue that, for example, the family farm insures a competitive market for agricultural products and can lead to the creation of positive social values and other outcomes. It is nearly impossible to quantify the extent to which first-time farmer bonds may create or contribute to these perceived benefits. However, to the extent these benefits are sizeable, they should be incorporated into any cost-benefit analysis.

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[3] This cost calculation is not the same as the revenue estimate for extending the qualified small-issue bond program for two reasons. First, the program is subject to the State private activity annual volume limitation. To the extent that the issuance of other private activity bonds would increase if the authority to issue qualified small-issue bonds were not extended, the revenue estimate of extension would be substantially lower than the economic cost of issuing qualified small-issue bonds. Second, the revenue estimate would not necessarily assume that investors would switch from holding qualified small-issue bonds to holding fully taxable investments.

[4] These additional benefits are referred to as "externalities" by economists.

B. Treatment of Certain Farm Property for Estate Tax Purposes

Present Law

A Federal estate tax is imposed on the value of property passing at death. Generally, the value of property is its fair market value, which is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

For decedents dying after December 31, 1976, the executor may elect to value real property that was used by the decedent as a farm or in another trade or business at its value as a farm or in the trade or business instead of its fair market value. In order to qualify for special use valuation, the real property must be used by the decedent or a member of the decedent's family as a farm for farming purposes or in another trade or business. An additional tax is imposed if the family member who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death.

Some courts have held that cash rental of specially valued property after the death of the decedent is not a qualified use and, therefore, results in a recapture tax. See, e.g., *Martin* v. *Commissioner,* 783 F.2d 81 (7th Cir. 1986) (cash lease to unrelated party); *Williamson* v. *Commissioner,* 93 T.C. 242 (1989) (cash lease to family member). A statutory rule treats a net cash lease by a surviving spouse to a member of the spouse's family as a qualified use.

For estate tax purposes, a charitable deduction sometimes is allowed for a decedent's contribution of an interest in real property to a charity exclusively for conservation purposes. A restriction on the use of real property qualifies for the deduction only if the restriction is granted in perpetuity and the conservation purpose is protected in perpetuity.

Explanation of the Bills

1. Special use valuation of sensitive environmental areas (S. 887—Senators Jeffords, Symms, Daschle, Bumpers, Craig, and Leahy)

S. 887 would allow the executor of an estate to value an interest in a sensitive environmental area at its environmental use value for Federal estate tax purposes. The environmental use value would be the value of the interest in a sensitive environmental area, subject to an environment preservation easement. A sensitive environmental area would be defined as a wetlands area or other area of undeveloped natural condition or open space. An environmental preservation easement would be defined as a preservation easement granted for 10 years beginning from the date of death.

Such easement could be granted by the decedent or executor, but would not qualify for a charitable deduction for income or estate tax purposes if granted by the latter.

A recapture tax would be imposed if, within 10 years, the heir ceases to maintain the property in accordance with the easement. The amount of the recapture tax would equal the greater of (1) the additional estate tax liability that would have been incurred had the value of the property been determined without regard to the environmental use value, or (2) the excess of the amount realized over the environmental use value of the interest.

Effective date.—The bill would apply to decedents dying after the date of enactment.

2. Special use treatment of rents paid to lineal descendants (S. 1045—Senators Kassebaum, Dole, and Conrad)

S. 1045 would provide that a cash rental of specially valued real property by a lineal descendant of the decedent to a member of the descendant's family would not result in the property failing to be treated as used in a qualified use for purposes of the special use valuation recapture tax.

Effective date.—The bill would apply to rentals occurring, and decedents dying, after December 31, 1976.

3. Special use treatment of rents paid to qualified heirs (S. 1061—Senators Conrad, Kassebaum, and Exon)

S. 1061 would provide that a cash rental of specially valued real property by a family member receiving the property to a member of the recipient's family would not result in the property failing to be treated as used in a qualified use for purposes of the special use valuation recapture tax.

Effective date.—The bill would apply to rentals occurring, and decedents dying, after December 31, 1976.

Analysis

Valuation based on environmental use

Generally, the environmental use value would be the value of property that must lay fallow or otherwise remain undeveloped. The effect of S. 887 would be to permit the executor to exclude from the taxable estate the difference between the fair market value and the environmental use value of the property. The exclusion is likely to be more valuable in areas close to other development, rather than in more remote locations. It also is more valuable to decedents with larger estates, and hence higher marginal estate tax rates.

As an exclusion from the taxable estate for a public purpose, S. 887 resembles the deduction for charitable bequests permitted under present law to a decedent granting such an easement to a charitable organization. It differs from the charitable deduction, however, by not requiring that the easement be perpetual or that the donee be a charity and by imposing a recapture tax if the property is not maintained in accordance with the easement.

Some may argue that the need to preserve environmentally sensitive areas is sufficiently strong to justify special treatment under

the Internal Revenue Code. S. 887 would provide an incentive for the creation of conservation easements by reducing the effective cost of such creation. It is uncertain, however, whether S. 887 would actually increase the number of conservation easements.[5]

Others may argue that the amount of the subsidy should not vary depending upon the decedent's estate tax bracket. They could also note that the Internal Revenue Code already provides a substantial incentive by allowing a charitable deduction for easements granted before death.

Moreover, others may prefer a direct expenditure program as a means of preserving open spaces. By providing planning and oversight, a direct expenditure program may be more efficient. For example, environmental goals may not be furthered if several acres of wetlands are preserved by an executor claiming an environmental easement, if the surrounding 100 acres of wetlands are developed. A direct expenditure program would have the opportunity to attempt to preserve a larger parcel or to determine that no environmental goal is furthered if only several acres were to be preserved. A direct expenditure program also might be more politically accountable.

Special use valuation

Some may argue that the benefit of special use valuation should not be lost merely because the property is cash leased. A similar benefit is already available through a crop share lease, a common alternative to cash leasing. A cash lease, however, provides a more reliable income stream.

Others may emphasize that current use valuation is a special provision designed to allow the continuation of family farms. Cash leases, even among family members, may give the benefit of special use valuation to persons insulated from the risk of farming. It can be argued that such benefit should be confined as narrowly as possible.

The retroactivity of the proposals may be an issue. Retroactivity is necessary if the bills are to reach all heirs who have entered into cash leases. On the other hand, retroactivity imposes an administrative burden upon the Internal Revenue Service by opening returns for past years.

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[5] For empirical studies reaching opposing conclusions regarding the effect of the charitable deduction on bequests, compare Thomas Barthold and Robert Plotnick, "Estate Taxation and Other Determinants of Charitable Bequests," 37 *National Tax Journal* 225 (June 1984) (charitable deduction does not increase charitable bequests), with David Joulfaian, "Charitable Bequests and Estate Taxes," 46 *National Tax Journal* 169 (June 1991) (charitable deduction increases charitable bequests).

C. Treatment of Gain from the Sale of Certain Farm Property

1. Gain on transfer of farm property to satisfy an indebtedness (S. 900—Senators Conrad, Daschle, Burdick, Dixon, Harkin, Heflin, Kerrey, Levin, and Symms)

Present Law

Gain on transfer of property in exchange for cancellation of indebtedness

Gain from the sale or other disposition of property is determined by computing the excess of the amount realized therefrom over the adjusted basis of the property. The amount realized is the sum of any money received plus the fair market value of any property (other than money) received. In general, the entire amount of gain determined on the sale or exchange of property is recognized for Federal income tax purposes (sec. 1001).

If a taxpayer transfers property to a creditor in exchange for the cancellation of an indebtedness, the taxpayer may recognize both gain on the property and cancellation of indebtedness income. The transfer of property in exchange for the cancellation of indebtedness is equivalent to a sale for Federal income tax purposes. For example, if the debt that is cancelled is one for which the taxpayer is personally liable, gain will be recognized in the amount of the excess of the fair market value of the property over the basis of the property. In addition, the taxpayer will have discharge of indebtedness income in an amount equal to the excess of the amount of the debt discharged over the fair market value of the property.

Cancellation of indebtedness income

In general

Gross income generally includes income from the discharge of indebtedness (sec. 61(a)(12)).

Treatment of insolvent taxpayer

If an insolvent taxpayer realizes income from discharge of indebtedness, the income is excluded and certain tax attributes of the taxpayer (including items such as net operating loss carryovers and basis in property) generally are reduced by the excluded amount. The exclusion is limited to the amount by which the taxpayer is insolvent. If the taxpayer's discharge of indebtedness income (not in excess of the amount by which the taxpayer is insolvent) exceeds these tax attributes, the excess is forgiven, i.e., is not includible in income (sec. 108).

Treatment of certain farm indebtedness

The Tax Reform Act of 1986 provided that, in the case of a solvent taxpayer who realizes income from the discharge by a "qualified person" of "qualified farm indebtedness," the discharge is treated in a manner similar to a discharge of indebtedness of an insolvent taxpayer (sec. 108(g)). Qualified farm indebtedness is indebtedness incurred directly in connection with the operation of a farming business by a taxpayer who satisfies a gross receipts test. The gross receipts test is satisfied if 50 percent or more of the taxpayer's average annual gross receipts for the three taxable years preceding the taxable year in which the discharge of indebtedness occurs is attributable to the trade or business of farming. A qualified person is one regularly engaged in the business of lending money and meeting certain other requirements. The Technical and Miscellaneous Revenue Act of 1988 provided that the amount excluded under this provision generally may not exceed the sum of the taxpayer's loss and credit carryovers and the taxpayer's basis in property held for use in a trade or business or for the production of income. Thus, if there is any remaining discharge of indebtedness income after the taxpayer has reduced these tax attributes, income will be recognized.

Explanation of the Bill

In general

S. 900 would provide tax relief for certain farmers who realize gain on the transfer of farm property in satisfaction of farm indebtedness. In addition, the bill provides that farmers meeting certain requirements could elect to exclude income from the discharge of farm indebtedness, subject to a maximum dollar limit.

Exclusion of certain gains

The bill would exclude from the gross income of certain farmers gain from the transfer of farm property in complete or partial satisfaction of qualified farm indebtedness (i.e., debt incurred directly in connection with the trade or business of farming in which the taxpayer materially participated), subject to a maximum of $300,000. This rule would apply to a taxpayer that satisfies the following requirements: (1) the average of the taxpayer's adjusted gross income (with certain modifications) for any three taxable years of the past five taxable years is less than the average of the national median adjusted gross income for such three taxable years; (2) more than 50 percent of the taxpayer's gross receipts for six of the 10 taxable years preceding the year of transfer is attributable to a farming business, the sale or lease of assets used in farming, or both; and (3) the amount of equity in all property held by the taxpayer after the transfer is less than the greater of (a) $25,000 or (b) 150 percent of the excess of the tax that would be due if this provision and section 108 of the Internal Revenue Code (which relates to exclusions of certain discharge of indebtedness income) did not apply, over the tax that would be due if this provision and section 108 did apply.

The bill provides that the $300,000 limit on excludable gains would be reduced by (1) prior year exclusions of gains under this provision, (2) current year and certain prior year exclusions of discharge of indebtedness income under section 108, and (3) gains recaptured as ordinary income. In addition, any amount that is excluded by reason of this provision would reduce certain tax attributes of the taxpayer.

Exclusion of discharge of indebtedness income

The bill provides that certain farmers may elect to exclude income from the discharge of qualified farm indebtedness, subject to a maximum of $300,000. An election may be made if a taxpayer meets the requirements described above and, in addition, the taxpayer's indebtedness both before and after the discharge is equal to 70 percent or more of the equity in all property held by the taxpayer.

The bill provides that the $300,000 limit would be reduced by prior year exclusions of gains from the transfer of farm property (under the provision described above) and prior year exclusions of discharge of qualified farm indebtedness income under this provision.

If an election is made, the amount of income from the discharge of qualified farm indebtedness that may be excluded would not be limited to the taxpayer's tax attributes; rather, the maximum amount that may be excluded would be $300,000. If an election is not made, however, the present-law rule that generally limits the exclusion of income to the sum of the taxpayer's loss and credit carryovers and the taxpayer's basis in certain property, would not be changed by this provision of the bill.

Effective date

The bill would apply to transfers and discharges of indebtedness occurring after December 31, 1986. In addition, in the case of any taxable year ending before the date of enactment, the statute of limitations for claiming a credit or refund generally would remain open until one year after the date of enactment.

Analysis

If an indebtedness of a taxpayer is cancelled in exchange for the transfer of property, the taxpayer may realize ordinary discharge of indebtedness income, gain or both. Under present law, a taxpayer may exclude only ordinary discharge of indebtedness income, under certain circumstances. There is no comparable exclusion for gain realized on the transfer of the property to a creditor, even though economically the taxpayer has been discharged from an indebtedness. Some may argue that the bill properly addresses this imbalance by treating both ordinary discharge of indebtedness income and gain similarly.

Others may argue, however, that the exclusion of income from the discharge of indebtedness (albeit requiring a reduction in tax attributes) is not a proper measurement of income and that such policy should not be extended to gain realized on the transfer of property to a creditor.

Those who believe that ordinary discharge of indebtedness income and gain should be treated similarly could argue that the scope of the bill is too narrow because it redresses the inequitable treatment of gain as compared to ordinary discharge income only in certain cases involving qualified farm indebtedness and not in other cases.

Administrative concerns of both the Internal Revenue Service and taxpayers may be raised by the bill because operation of certain aspects of the bill would involve the retention of tax return and other information for many years (e.g., the "six out of 10 years" gross receipts test and the $300,000 lifetime cap).

2. Rollover of gain from the sale of farm assets into an asset rollover account (S. 1130—Senators Kasten, Shelby, and Burns)

Present Law

Under present law, gain from the sale of farm assets is generally includible in income for the taxable year in which the assets are sold.

Explanation of the Bill

The bill would permit a qualified farmer to defer recognition of a limited amount of net gain from the sale of qualified farm assets to the extent the farmer contributes an amount equal to such gain to one or more asset rollover accounts ("ARAs") in the taxable year in which the sale occurs. An ARA would be an individual retirement arrangement ("IRA") that is designated at the time of establishment as an ARA. Except as provided under the bill, an ARA would be treated in the same manner as an IRA. Thus, amounts contributed to an ARA would not be includible in income until withdrawn from the ARA. However, no deduction would be allowed for contributions to an ARA, and rollover contributions to an ARA could be made only from other ARAs.

Contributions to one or more ARAs (and thus deferral of qualified net farm gain) in any taxable year would be limited to the lesser of (1) the qualified net farm gain for the taxable year, or (2) an amount determined by multiplying the number of years the taxpayer is a qualified farmer by $10,000 ($20,000 for joint filers in each year the taxpayer's spouse also is qualified farmer). In addition, the aggregate amount for all taxable years that could be contributed to all ARAs established on behalf of an individual could not exceed $500,000 ($250,000 in the case of separate return by a married individual), reduced by the amount by which the aggregate value of assets held by the individual and the individual's spouse in IRAs (other than ARAs) exceeds $100,000. A taxpayer would be deemed to have made a contribution to an ARA on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the individual's Federal income tax return for the year (not including extensions).

Under the bill, qualified net farm gain would be defined as the lesser of (1) the net capital gain of the taxpayer for the taxable year, or (2) the net capital gain for the taxable year determined by

taking into account only gain (or loss) in connection with a disposition of a qualified farm asset. A qualified farm asset would be an asset used by a qualified farmer in the active conduct of the trade or business of farming. A qualified farmer would be a taxpayer who during the 5-year period ending on the date of the disposition of a qualified farm asset materially participated in the trade or business of farming, and 50 percent or more of such trade or business is owned by the taxpayer (or spouse) during the 5-year period.

Any individual who made a qualified contribution to, or who received any amount from, an ARA for any taxable year would have to include on the individual's Federal income tax return for such taxable year and any succeeding taxable year (or on such other form as the Secretary may prescribe) information similar to that required in the case of designated nondeductible contributions to an IRA. Excess contributions to an ARA would be subject to the penalties applicable to excess contributions to an IRA.

Effective date.—The bill would apply to sales and exchanges occurring after the date of enactment.

Analysis

S. 1130 would permit farmers to convert the equity in farm assets into retirement savings without having to first pay tax on accrued gain in the value of the assets. As S. 1130 does not require the taxpayer to recognize the gain prior to contributing the proceeds to an ARA, the proposal is equivalent to permitting the taxpayer to make a tax deductible contribution to an IRA where the size of the deduction permitted is equal to the size of the gain. Permitting such gain to be contributed to an ARA on a pre-tax basis is equivalent to exempting from tax the earnings on what would otherwise be a post-tax investment.[6] This would offer the farmer a greater after-tax return than would many other alternative investments. In addition, farmers would postpone taxation of the contributed gain until the contributions are withdrawn, at which time they may be taxed at a lower rate than when the contribution was made.[7]

Under present law, farmers can establish an IRA or their own tax-qualified retirement saving plan. S. 1130 would provide an additional benefit to farmers. However, S. 1130 would limit the extent to which a taxpayer could avail himself or herself of both an IRA and the rollover of qualified farm gain. By linking gains in the value of farm property to IRA assets, the bill may provide an in-

[6] The following example illustrates why an investment in an ARA that is not first subject to tax receives a tax-free rate of return. Assume a taxpayer with a marginal tax rate of 28 percent contributes $1,000 to an ARA. The initial savings from not having to pay tax on the $1,000 is $280. For the purpose of this example, assume that the taxpayer withdraws the funds after one year without penalty. If the annual rate of return on the ARA assets is 10 percent, the value of the ARA is $1,100, total tax due is $308, and the taxpayer is left with $792. Notice that if the taxpayer had paid the initial tax of $280 and invested the remaining $720 at 10 percent, then the taxpayer would have had $792 after one year. If the income had not been invested in an ARA, the taxpayer would have to pay tax on the $72 of earnings, and would be left with $771.84 after payment of taxes. The value of the ARA is that the taxpayer does not have to pay additional tax. Thus, the ARA allows the taxpayer to get a tax-free rate of return on an investment of $720.

[7] For a detailed discussion of the economics of IRAs see, Joint Committee on Taxation, *Description and Analysis of S. 612 (Savings and Investment Incentive Act of 1991)* (JCS-5-91), May 14, 1991.

centive for farmers to redirect funds which they may otherwise have put into an IRA into investments in their farm property. While this may lead to improvement in farm productivity it may also increase the riskiness of the taxpayer's retirement savings by reducing his or her diversification.

The rollover of gain on qualified farm property into an ARA would effectively create income averaging for the taxpayer in regard to recognition of gain. Rather than see recognition of a large gain place the farmer in what may be a temporarily high tax bracket, the IRA distribution rules would permit the taxpayer to recognize income, and pay tax, gradually over a period of years. Under present law, the taxpayer could effectively avoid the increased tax burden created by a large gain placing the taxpayer in a temporarily higher tax bracket by selling the property on an installment basis. However, the installment sale does not offer the benefit of effectively exempting from tax the interest charged on the installment sale.

The ARA, by effectively exempting the income on the invested proceeds from tax, would provide a greater benefit to a taxpayer who otherwise would be in a high tax bracket than to a taxpayer in a lower tax bracket.

3. Exclusion of gain on the sale of farmland with an adjoining principal residence (S. 2202—Senator Kassebaum)

Present Law

In general, a taxpayer may elect to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale and (2) has owned and used the residence as a principal residence for three or more years of the five years preceding sale of the residence (sec. 121). In the case of property held jointly by a husband and wife who are filing a joint return, if one spouse satisfies the age, ownership, and use requirements, then both are treated as satisfying the requirements. Generally, farmland does not qualify under the definition of principal residence for purposes of the exclusion. The taxpayer may only make the election once in his or her lifetime.

Explanation of the Bill

The bill would modify the one-time exclusion of gain that applies to the sale of a principal residence by individuals who have attained age 55.

Specifically, the exclusion would be extended to include any adjoining farmland on which the principal residence is located. The exclusion would only apply to farmland sold with the principal residence. In addition, the exclusion would only apply to farmland which has been actively farmed by the taxpayer.

Effective date.—The bill would apply to sales and exchanges of principal residences occurring after December 31, 1991.

Analysis

Congressional intent behind the present-law exclusion of up to $125,000 of gain from the sale of a principal residence is based on

the belief that in the case of long-held assets such as a personal residence a substantial portion of any realized gain represents inflationary gain rather than a real (inflation adjusted) increase in economic value. The taxation of return to investment in the United States generally involves the imposition of the tax on the nominal return, rather than the real return. One rationale for attempting an adjustment for inflationary gains on principal residences is that for many taxpayers, their principal residence is their primary source of net wealth. Based on this rationale, it may be appropriate to extend the present-law exclusion to farmers for farmland contiguous to the principal residence, as the farmland generally represents the primary source of net wealth for family farmers. However, the same rationale would argue for extending the exclusion to any asset which represents a substantial portion of a taxpayer's wealth.

On the other hand, a uniform $125,000 exclusion from income is a very imprecise measure of inflationary gain. The extent to which the present-law exclusion offsets only inflation depends upon the taxpayer's basis in his or her residence, the taxpayer's holding period, the rate of inflation, and the real rate of return accrued by the residence. Thus, for a taxpayer who purchased a residence that had a very high real return during a brief period of low inflation, the present-law exclusion may offset all inflationary gains and a portion of the real gain. But, for a taxpayer who purchased a residence which had little real return during a period of higher inflation, the present-law exclusion may not offset all of the inflationary gain. Because present law does not attempt to accurately measure inflation, the benefit of the present-law exclusion accrues unevenly to taxpayers by location. Real returns to the ownership of real property are unequal depending upon where the property is located. S. 2202 would be expected to have the same effect as real returns to farmland have varied substantially depending upon location.

Frequently, the principal residence and farmland surrounding it are sold jointly. The principal residence may serve as an integral part of the farm operation (for example, serving as business office and dining hall for farm laborers). Administratively, it may prove difficult or arbitrary to apportion gain separately to the farmland and principal residence, and administrative ease may be facilitated by extending the present-law exclusion applicable to a primary residence to a primary residence and surrounding farmland. On the other hand, extending the exclusion to farmland would have the effect of extending the present exclusion for gain on a personal residence to business-related assets.

Prepared Statement of Richard L. Dees

I. QUALIFIED USE TEST CLARIFICATION

The Problem: The IRS contends and the Tax Court in one case has held that family members who have inherited farmland valued at its use value pursuant to IRC §2032A cannot cash rent to each other without a recapture of the estate tax savings. The IRS is enforcing this position against legitimate family farmers who did not know of this prohibition or otherwise could have used a crop share lease or an installment sale to avoid recapture. Moreover, the IRS has directed its enforcement actions against farmers in the Plains states and Minnesota who made elections before its position was known, and who do not have the resources to challenge the IRS in court. Congressional action is required because the courts have relied on legislative history to narrow the definition of qualified use; even as Congress has tried to liberalize its definition.

The Solution: The qualified use test should be clarified so as to permit family members to cash rent to each other without a recapture of the estate tax savings attributable to the IRC §2032A election. This is currently the pre-death rule. This should be applied retroactively to all estates as the impact of the IRS position is solely against those estates that were unaware of the cash rent prohibition.

Discussion: I ask that the full statements of Janet and Craig Kretschmar and myself and the Illinois State Bar Association from January 23, 1990, addressing this issue be included in the record. I will limit myself to replying to the arguments presented against the change and to explaining the Congressional and IRS action that resulted in the current confused state of the law.

IRS Argument 1: Family Members who are not farmers may benefit from special use valuation.

IRC §2032A specifically contemplates that both active and inactive family members can inherit farmland and as long as one family member continues to materially participate (the statutory touchstone for maintenance of the estate tax savings) that no recapture of estate tax savings will result. The IRS qualified use position imposes an extra requirement the inactive family members must crop share to the active farmers rather than cash lease.

IRS Argument 2: By cash leasing to each other for generations dynasties can result without any continuing family connection to the farms.

The definition of "family member" limits the benefits of family member participation to a single generation. If a sister who has been relying on a brother's material participation dies, then her estate will not continue to qualify for IRC §2032A unless her children or husband begin to materially participate.

IRS Argument 3: Cash rents are inherently bad to the continuing farmers.

Cash rents provide a way to compensate those family members have special income needs when the only alternative would be the sale of the farm. The purpose of IRC §2032A was to avoid the need to sell the farm and, therefore, permitting family member cash rents is consistent with the purpose. It is the IRS position that would force a sale rather than permit cash rent that is inconsistent with the statute.

IRS Argument 4: IRC §2032A is a significant benefit and its requirements should be strictly enforced.

IRC §2032A does impose a number of requirements to obtain the estate tax savings; however, Congress enacted these requirements to ensure that only legitimate family farms benefit from the estate tax savings. Rather, than enforce this policy, the IRS has used technicalities to deny the estate tax savings benefits to legitimate family farms.

IRS Argument 5: Retroactive legislation would award those persons acting contrary to IRS regulations.

Individuals who had notice of the IRS qualified use requirement could use a crop share lease or an intra-family installment sale to avoid recapture. The IRS understands this and has directed its enforcement actions against estates electing IRC §2032A many years ago before its current position became known in litigation. Although some have contended that this IRS position has long been contained in the regulations, actually the regulations relate to business entities that have a separate test. More importantly, the IRS in non-litigated situations as interpreted its regulations as permitting family member cash rents as one can see from the chart on the following pages. Unfortunately, farm families have conceded the qualified use issue rather than expend the significant resources necessary to fight the IRS in court.

IRS Argument 6: Congress has narrowed the qualified use test in subsequent legislative history.

It is a matter of basic constitutional law that Congress can act only through legislation passed by both houses and signed by the president or passed over his veto. The notion that legislative history of a later Congressional committee can change the law is foreign to our legal system. Moreover, it presumes that Congress would act to liberalize the law to ensure that its original intent was followed through liberalizing legislation, but act to narrow the law through legislative history without any policy justification.

As the chart on the following pages show the IRS qualified use test is inconsistent with the positions of the IRS and the contemporaneous legislative history of IRC §2032A as enacted in 1976. Only certain legislative history accompanying amendments to §2032A intended to liberalize the statute supports the IRS position. The result—a comedy of errors—but without any humor to the farm families whose very farms are jeopardized.

II. CURING DEFECTIVE SECTION 2032A ELECTIONS

Problem: The IRS imposes technical requirements as to the form of the election and the agreement signed by the qualified heirs so as to deny legitimate farm families the Congressionally intended benefits of IRC §2032A.

Solution: Adopt the proposed simplification provision that would give the estate and qualified heirs 90 days to correct any defects in the election or the agreement.

Discussion: This was in fact the intent of the Dixon Amendment enacted in 1984. The following is from his floor statement (Congressional Record Senate 4318–19 (April 11, 1984)):

> Mr. President, this is a very simple and straightforward amendment. It attempts to deal with a policy of at least certain agents of the IRS that has the effect of undermining the actions Congress has taken to try to preserve family farms and other small family businesses.
>
> The law and the report [to the Tax Reform Act of 1976] both state and public policy issue directly and forcefully. Congress wants to continue the family farm and small, family-owned enterprises,. Congress does not want the death of the owner of a family farm or small, family-operated business to force the sale of that farm or business if the family wants to stay in farming or the small business. The idea was to not permit the federal estate tax to destroy family farms or small businesses.
>
> There seem to be people at the IRS, however, who are not interested in preserving family farms and small businesses, and who want to use the slightest technicality to prevent an estate from being valued under the provisions of Section 2032A. Let me give you to examples of steps the IRS seems willing to take in its effort to break up family farms and small businesses.
>
> Mr. President, as I read subsection (D) [sic] of Section 2032A, the IRS already has sufficient discretion to permit parties to correct any good faith technical mistakes they make when filing applications for this special valuation treatment. However, the service seems to take the opposite view. Clarification of Congressional intent by amending the section is therefore necessary.
>
> This may all sound very obscure and unimportant. But it is very important to family farmers and family-operated, small businesses. These families want a chance to be able to continue their family traditions through the generations. Congress has clearly decided to give them that opportunity and not to let the death of the head of a family force the sale of the family farm or business because of the need to pay federal estate taxes.

It is particularly frustrating to family farmers that the IRS has recently expanded Treas. Reg. §301.9100–1 to permit a taxpayer to cure a defective tax election, but has not applied that relief fully to Section 2032A—despite granting the relief under similar circumstances to marital deduction elections under the estate tax. Ironically, in Private Ruling No. 9215003 (December 16, 1991), in terms hearkening back to the qualified use test, the IRS relied on the Dixon amendment and its substantial compliance requirement that was added in the legislative process as a reason for denying the relief.

The proposed simplification giving 90 days to cure a defective election should be enacted and applied retroactively.

III. LOSS OF SPECIALLY VALUED FARMLAND THROUGH FORECLOSURE

Problem: Farmland lost to the family by foreclosure or transferred to a creditor in lieu of foreclosure still can result in recapture and estate tax liability to the family. In one estate I am advising an estate with a fair market value of $1,000,000 has been essentially lost with the family still owing as much as $200,000 in estate and recapture tax and penalties and interest.

Solution: The IRS should be given the authority to forgive taxes, interest or penalty when an estate electing Section 2032A or 6166 installment payments is foreclosed on or otherwise lost to creditors without pursuing the separate assets of heirs.

Discussion: Most of these cases involve the estates of decedents dying prior to 1983 when exceptionally high estate taxes combined with exceptionally high land values. Indeed, the 1980 land values many times exceed the current value of the farmland some ten years later. Without this legislation, the IRS will be required to drive the heirs into bankruptcy chasing these taxes. Yet the IRS won't likely collect that much more in taxes when the cost of those proceedings is considered.

IV. INCREASING THE MAXIMUM VALUE REDUCTION

Problem: The maximum value reduction of $750,000 from the use of Section 2032A has not been increased since 1981. This limit is so low that Section 2032A cannot be utilized effectively by farmers in urban or suburban locations. Thus farmers in these locations either sell off the farms or use other valuation reduction and estate tax savings devices without the 10 year commitment to continue the family farm. Thus some of the most crucial farms to save are lost each year.

Solution: Either the valuation reduction limitation should be removed or a minimum number of acres should receive an unlimited limit.

Discussion: If you look at Illinois farmland with a fair market value of $2500 per acre and a value as a farm of $1000 per acre, then 500 acres can be specially valued before reaching the maximum value reduction. If you look at a farm in Lake County in the six county Chicago metro area, then its fair market value is likely $20,000 per acre with a similar use value. Thus the Lake County farm would reach the maximum reduction with 40 acres. While it is questionable whether a 500 acre farm is sufficiently large to be productive and efficient, there is no question that a 40 acre farm is too small.

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Chart on Legislative and Regulatory History of the Qualified Use Test

Actor	Date	Action	Citation
Congress	10/4/76	Enactment of Section 2032A which contained a post-death qualified use requirement as follows: *... real property shall cease to be used for a qualified use if --* *... such property ceases to be used for the qualified use set forth in [citations] under which the property qualified ...* The original statute further defined qualified use as: *... the devotion of the property to any of the following:* *(A) u. as a farm for farming purposes, or* *(B) use in a trade or business other than the trade or business of farming.*	IRC § 2032A(c)(6) IRC § 2032A(b)(2)

Chart on Legislative and Regulatory History of the Qualified Use Test

Actor	Date	Action	Citation
Congress	8/2/76	The contemporaneous legislative history to Section 2032A clearly contemplated that the qualified use need not be by the decedent or the qualified heir as long as a family member materially participated: *As indicated above, real property which is used in a trade or business other than the trade or business of farming may also qualify for special use valuation so long as the property was used in a trade or business in which the decedent or a member of his family materially participated prior to the decedent's death. This is true* ***even though the party carrying on the business was not the decedent or a member of his family*** *so long as the decedent or a member of his family materially participated in the business. [Emphasis added]*	House Report 94-1380, p. 23

Chart on Legislative and Regulatory History of the Qualified Use Test

Actor	Date	Action	Citation
IRS	11/19/80 12/31/80	However, in two private letter rulings the IRS adopted a contrary position with respect to the pre-death qualified use test reading into the statute (out of thin air) the bold language set forth below: *... real property shall cease to be used for a qualified use* ***by the qualified heir*** *if --* *... such property ceases to be used for the qualified use set forth in [citations] under which the property qualified ...* *... the devotion of the property to any of the following:* *(A) use as a farm for farming purposes* ***in the trade or business of farming,*** *or ...*	Private Rulings #8107142 and #8114033
Congress	4/27/81	Subcommittee on Oversight of the Internal Revenue Service of the Senate Finance Committee criticized the IRS for its highly technical positions, including its qualified use position, denying the benefit of special use valuation to deserving farm families. The subcommittee agreed to support legislation overturning the IRS position.	HG-97-22
Treasury	4/27/81	In a news release to accompany its testimony at that hearings, Treasury specifically repudiated its own qualified use test.	News Release R-147

Chart on Legislative and Regulatory History of the Qualified Use Test			
Actor	**Date**	**Action**	**Citation**
Treasury	7/7/81	Treasury amended its regulations to repudiate its qualified use test officially as to family members and leaves open the application of the qualified use test to non-family members: *The regulations at section 20.2032A-3(b)(1) require (1) that a qualified heir receive or acquire a "present interest" in property before it may be considered qualified real property, and (2) that the decedent have an equity interest in the operation of the farm or other business.* ***It has also been determined that the equity interest requirement may be satisfied by either the decedent or a member of the decedent's family. Thus, a passive rental of a farm by a decedent to a member of the decedent's family should not disqualify the property from special use valuation.*** *[Emphasis added]* *The purpose of this regulation is to implement these decisions.* *Because this regulation is liberalizing in nature, it is found unnecessary to issue this Treasury decision with notice and public procedure. At a future date the regulations will be reviewed to provide guidance where the parties involved include persons other than qualified heirs and members of the decedent's family.*	Treasury Decision 7786

Chart on Legislative and Regulatory History of the Qualified Use Test

Actor	Date	Action	Citation
Congress	8/13/81	The Congress then codified the IRS change of position with an amendment to the qualified use test providing specifically that cash rents between the decedent and family members prior to death would not disqualify special use valuation.	Economic Recovery Tax Act of 1981 §421(b)(1)
	7/6/81	Despite the IRS own repudiation of its qualified use test and the 1976 committee report language the Senate Report stated that *non-family* cash rents would fail the qualified use test.	Senate Report 97-144, p. 133
	12/29/81	The Bluebook went further and implied that family member cash rents after death might be a problem.	Joint Committee of Taxation Staff Explanation, p. 249-50
Congress	11/10/88	In 1988 Congress enacted legislation retroactively permitted surviving spouses to cash lease to their lineal descendants without recapturing the estate tax savings. Proposed language to make it clear that Congress was not narrowing the qualified use test was scored and, thus, not included.	Technical and Miscellaneous Revenue Act of 1988 §6151(a)

PREPARED STATEMENT OF REPRESENTATIVE BYRON L. DORGAN

Mr. Chairman and members of the Subcommittee, I am very pleased to address you about the issue of tax fairness for farmers.

America "all-star" entrepreneurs are the family farmers, ranchers and small business people who work hard and struggle and take risks everyday to make a living by their own toil, imagination and guts. Yet, the tax code frequently tells these folks that they are to be treated less favorably than other taxpayers.

In many instances, the tax code unfairly discriminates against farmers and other self-employed business owners with respect to tax items. And over the past decade I've sponsored several pieces of legislation to correct these problems.

Today's hearing examines several bills to provide much needed help to ensure that family farmers retain a major role in this nation's future. The bills would assist first-time farmers by permanently extending the first-time farmer bond provision, provide capital gains relief for farmers seeking to retire, and encourage farmers to pass farm operations down to the next generations. And I've worked hard to pass virtually identical legislation in the House of Representatives.

Yet, it seems to me that one of the most inexplicable provision in the tax code relates to the deductibility of health insurance costs for farmers and other self-employed individuals. When certain requirements are met, self-employed individuals are permitted to deduct only 25 percent of their expenses for health insurance. But, competitors organized as large corporations are able to take advantage of full deductibility of these same health costs. The same tax treatment should be available for self-employed taxpayers. It's just that simple.

Saving and expanding the health insurance tax deduction is critically important to farmers because the risky nature of their jobs are reflected in higher health insurance premiums. Each year I have pushed my colleagues in the House to correct this inequity in the tax code by phasing in 100 percent deductibility for the self-employed's health insurance premiums. We ought to fix tax laws that unjustly treat our farmers and other self-employed people who make up the backbone of the nation's economy. And we must move quickly to lessen the impact that this tax injustice has on health policy.

Over 34 million Americans are currently without any health insurance including many self-employed farmers and business owners. As health care costs continue to spiral upward, millions of U.S. workers who are self-employed may be forced to drastically reduce or eliminate health insurance coverage.

It seems to me that the code's health tax deduction provisions run counter to the incentives we ought to be providing. We must encourage broader health care coverage in this country to help remove a growing number of Americans from the list of the uninsured.

I also have been fighting to change a provision in the tax code that is inequitable to family farmers who retire and sell their farms. Current law allows those taxpayers over the age of 55 to exclude from federal income tax $125,000 of gain on the sale of their principal residence. That is fair treatment for most urban dwellers who typically may benefit from most of that tax exclusion.

But, family farmers aren't able to receive much of that benefit because the IRS separates the value of their home from the value of the quarter section of land the home sits on. As people from my state of North Dakota know, houses out on the farmsteads of rural America are more commonly sold for $5,000 to $40,000. Most farmers are putting their retirement savings into the whole farm rather than into a house that will hold little value at retirement time. And as a result, homes far out in the country are frequently judged by the IRS to have very little value and thus farmers receive much less benefit from this exclusion than others who sell their primary residences in town.

I recently introduced legislation to redefine current law's tax exclusion to apply to the farm home and the quarter section of land that the home sits on. This legislation is identical to my amendment to the "Tax Fairness and Economic Growth Act of 1992" that was passed by Congress early this year, but vetoed by the President.

Specifically, the provision will allow a person who is actively engaged in farming, and over 55 years old, to exclude the gain on up to 160 acres of land contiguous to the farm house. I believe that this legislation will finally allow retiring farmers the same type of tax exclusion that others have received for decades. And I urge my colleagues to support this proposal to ensure that farmers get a more equitable share of the personal residence tax exclusion.

Mr. Chairman, I appreciate the opportunity to testify before this Subcommittee. I think that a number of bills being considered at today's hearing are very important, but none quite so important as the health tax deduction for the self-employed that's scheduled to expire this summer. We now face the challenge of providing ac-

cessible health care to all Americans, and our failure to provide an equitable health tax deduction may force the self-employed to rely solely on government health care assistance rather than allowing them to provide for their own health care needs.

PREPARED STATEMENT OF JAMES FIELDS

Mr. Chairman and Members of the Subcommittee: It is a pleasure to be here today to present the Administration's views on proposed legislation generally relating to the Federal income tax treatment of "family farms." We recognize the economic difficulties facing family farms. As a consequence of a variety of economic forces, there has been a steady reduction in the number of family farms and fewer individuals are entering into the small-scale farming business.

The Administration is committed to providing for the survival and success of family farms. A number of the proposals in the President's 1993 Budget would assist farmers and would be particularly beneficial to family farmers, including a capital gains exclusion, the "Investment Tax Allowance," an extension of the health insurance deduction for self-employed persons, the "Family Tax Allowance" and an extension of first-time farmer bonds.

While the Administration commends the Subcommittee for its concern for the family farm, certain of the proposals under consideration by this Subcommittee will result in substantially reduced revenues, without inclusion of appropriate offsets. The proposals represent significant tax expenditures that must satisfy the pay-as-you-go requirements of the Omnibus Budget Reconciliation Act of 1990.

The Administration is also concerned that certain of the proposals do not reflect an appropriate balancing of the considerations that justify new tax expenditures. Any tax expenditure, regardless of the desirability of its objectives, must reflect a proper balancing of efficiency, fairness and administrability. Efficiency requires that the tax expenditure be the least-cost method of achieving its objective. Fairness requires that similarly situated persons receive similar treatment. Administrability requires that the complexity of the scheme properly reflect the sophistication of the taxpayers subject to it. Only certain of the provisions considered today reflect the proper balance.

The Administration's views regarding each of the proposals is set forth below.

I. S. 710—FIRST-TIME FARMER BONDS EXTENDED PERMANENTLY

Current Law. State and local governments may use proceeds of tax-exempt bonds to make loans to private individuals or entities to acquire farmland and equipment for certain first-time farmers or to acquire or construct manufacturing facilities. Proceeds of qualified small issue bonds loaned to first-time farmers may not exceed $250,000 per farmer and may be used only to acquire qualifying farmland and certain farm-related depreciable property. Only individuals or entities with relatively small capital investments (i.e., less than $1 million in some cases and less than $10 million in other cases) in the jurisdiction of the issuer of the bonds are eligible to use qualified small issue bonds for manufacturing facilities.

Qualified small issue bonds are subject to the tax-exempt bond volume cap and must compete with other private activity bonds for a share of a state's volume cap. The authority to issue qualified small issue bonds is set to expire on June 30, 1992.

Proposal. The authority to issue qualified small issue bonds for first-time farmers would be made permanent.

Administration Position. The Administration supports an 18 month extension of the authority to issue first-time farmer bonds in connection with a package of extensions of expiring tax provisions.

II. S. 887—WETLANDS AND GREEN SPACE PRESERVATION ASSISTANCE ACT OF 1991

Current law. Section 2032A of the Internal Revenue Code of 1986 (the "Code") provides that, under certain circumstances, a decedent's estate may elect to value real property used in a farm or a trade or business (a "qualified use") which passes to a member of the decedent's family (a "qualified heir") on the basis of its actual use rather than its highest and best use. The estate tax benefit of the special valuation is recaptured if the qualified heir disposes of the property (other than to a family member) or ceases to use the property in the qualified use within 10 years after the decedent's death.

Section 2055 of the Code provides for an estate tax charitable deduction for certain perpetual conservation easements granted on the death of the grantor. Similarly, if property owned by a decedent at death is already subject to a preservation

easement, the easement is taken into account in valuing the property for Federal estate tax purposes in appropriate circumstances.

Section 170 of the Code provides for an income tax charitable deduction for certain perpetual conservation easements. Generally, gifts of the use of property do not qualify for a charitable deduction.

Proposal. For estate tax purposes, a decedent's executor could elect to value any interest in any wetlands area (as defined by Federal law) or any other area of undeveloped natural condition or open space based on its environmental use value if the property is subject to a 10-year preservation easement measured from the date of the decedent's death. The easement could be granted by the decedent or by the decedent's executor with the consent of the qualified heirs who inherit the property. As in the case of special use valuation for farm property, the estate tax savings from the special environmental use valuation would be subject to recapture if the preservation easement is not maintained for the 10-year period. The proposal would be effective for decedents dying after the date of enactment.

Administration position. The Administration does not support this provision. The Code already provides charitable deductions for income, estate and gift tax purposes for qualified preservation easements. Thus, the proposed valuation rule is not necessary to encourage the granting of such easements and, as discussed below, might actually reduce the stock of real property preserved. In addition, unlike the special use valuation of section 2032A of the Code, the proposal cannot be justified as a reasonable protection of small family businesses or farms. The special use valuation for farm and business real property under section 2032A is available only in cases where the property is used in a qualified use for periods both before the decedent's death and for a period of 10 years thereafter. The purpose of those rules is to prevent having to sell an existing family farm or business to pay estate taxes. This concern is not reflected in the proposed rule which does not depend on the use of the property prior to the decedent's death.

The proposal does not represent an efficient means for promoting conservation easements. The proposal provides few of the requirements of current law to assure the creation and preservation of valuable easements. The proposal defines environmentally sensitive areas broadly and does not require that areas preserved result in public benefit. The proposal does not include a public access requirement. There is no assurance that the public may use or even view the property. The proposal does not require that the transferee of the easement be a charitable organization. The transferee may be a related party who may enjoy use of the property, possibly to the exclusion of the public, and may not have sufficiently adverse interest to the property owner to assure maintenance of the conservation purpose. Based on the foregoing, it is not clear that the proposal would result in any meaningful preservation or public benefit. In addition, if the proposed valuation rule encourages the granting of limited easements at the expense of the perpetual easements now subsidized by the tax law, the proposal could result in an overall reduction in the stock of protected real property.

The Administration also has concerns regarding potential revenue loss from this provision. The 10 year easement may be used as a simple, relatively low-cost planning device to avoid estate taxation for high net-worth individuals. For example, urban land held by a real estate developer could qualify. If, under the proposal, the property were valued on the basis of its encumbered use, the economic cost of granting an easement could be far less than the reduction in the estate's value for tax purposes. The proposal's value as a planning tool is increased because, in contrast with section 2032A, the proposal contains no limitation on the possible reduction in estate value. Moreover, in contrast with the current law governing conservation easements, the proposal does not make adjustments for benefits to other property held by the estate or heirs arising from the easement.

III. S. 1045 AND S. 1061—ELECTION OF SPECIAL USE VALUATION OF FARM PROPERTY FOR ESTATE TAX PURPOSES

Current law. Under current law, a decedent's estate may elect to value real property used in a farm or a trade or business (a "qualified use") which passes to a member of the decedent's family (a "qualified heir") on the basis of its actual use rather than its highest and best use. The estate tax benefit of the special valuation is recaptured if the qualified heir disposes of the property (other than to a family member) or ceases to use the property in the qualified use within 10 years after the decedent's death. Generally, a net cash lease of the property by a qualified heir is not a qualified use. However, a net cash lease of the property by a surviving spouse to a member of his or her family is not treated as a failure to use the property in a

qualified use. In contrast with a net cash lease, a "crop sharing" agreement is treated as a qualified use.

Proposal. Under S. 1045, lineal descendants of the decedent, as well as the decedent's spouse, would be able to net cash lease to members of their families without failing the qualified use test. Under S. 1061, any qualified heir could rent the property to a member of the heir's family on a net cash basis. Both proposals would be effective as if included in the amendment to section 2032A of the Code made by the Technical and Miscellaneous Revenue Act of 1988 and would therefore apply to the estates of decedents dying after December 31, 1976.

Administration Position. The Administration supports S. 1045 subject to modification of its effective date to provide for prospective application only. In general, section 2032A requires a qualified heir to have an "equity interest" in the farm or business performance to meet the qualified use standard. Net cash leasing is generally inconsistent with that policy. However, to allow needed flexibility, the Administration would not oppose limited extension of the right to cash lease specially-valued real property. We believe that the extension of the current rule proposed in S. 1045 represents a reasonable balancing of the need for flexibility in the context of the family farm or business and the general policy of requiring a qualified heir to maintain an equity interest in the farm or business.

IV. S. 900—FARM DEBT TAX REFORM ACT OF 1991

Present Law. Cancellation of debt income ("COD income") realized by an insolvent taxpayer (but only to the extent of the insolvency) or a bankrupt taxpayer is excluded from income and the taxpayer is instead required to reduce certain tax attributes (generally including net operating losses and basis in property). If realized COD income exceeds the amount of tax attributes, the excess is forgiven.

Under section 108(g) of the Code, to the extent a solvent farmer has tax attributes, COD income realized by the farmer from the discharge of farm indebtedness is excluded from income and the tax attributes are instead reduced. Realized COD income in excess of tax attributes is included in income.

Gain recognized by a farmer on the transfer of farm property in partial or complete satisfaction of farm indebtedness is included in income. This result occurs regardless of whether the farmer is solvent, insolvent, or bankrupt or whether the gain is capital gain or treated as ordinary income under the recapture provisions.

Proposal. The proposal would provide two forms of tax relief for qualifying farmers. First, a qualifying farmer would exclude gain arising from the transfer of farm property in complete or partial satisfaction of farm indebtedness. The farmer would have to reduce tax attributes on account of excluded gain under the same rules applicable to COD income. Any gain in excess of attributes would be forgiven. The exclusion of gain would apply regardless of whether the farmer is solvent, insolvent, or bankrupt [or whether the gain is capital gain or treated as ordinary income under the recapture provisions]. Second, a qualifying farmer could elect to exclude COD income from the discharge of farm indebtedness. The farmer would have to reduce tax attributes as a result of excluded COD income. Any excess COD income would be forgiven. (Because excess COD income is already forgiven in the case of insolvent and bankrupt farmers, the second provision effectively benefits only solvent farmers). Relief under these two provisions would be subject to a combined lifetime cap of $300,000 of taxable income.

To qualify for relief, (1) the farmer's adjusted gross income (with certain modifications) in 3 of the 5 taxable years ending with the year of discharge must be less than the average national median adjusted gross income; (2) more than 50 percent of the farmer's gross receipts for 6 of the 10 taxable years preceding such year must be attributable to farming, the sale or lease of assets used in farming, or both; (3) the farmer must have materially participated in the farming business when the farm indebtedness was incurred; and (4) the amount of equity in all property held by the farmer after the transfer or discharge must be less than the greater of $25,000 or 150 percent of the additional tax that would be incurred as a result of the transfer or discharge if the resulting gain or COD income were not excluded. As an additional condition on the exclusion of COD income, the farmer's indebtedness both before and after the discharge must equal at least 70 percent of the value of all property held by the farmer.

Under the proposal, relief would apply retroactively to transactions after December 31, 1986 and claims for credit or refund based on the relief that otherwise would be barred under the statute of limitations would be allowed within 1 year of the date of enactment.

Administration position. The Administration opposes the proposal because it does not appropriately balance efficiency, fairness and administrability and because it would result in substantial revenue loss.

The proposal does not satisfy the requirements of fairness. It applies only to farmers. Many small family businesses are suffering financial difficulties. There is no policy justification for distinguishing between farmers and any other troubled family business for the purpose of debt forgiveness.

Further, the proposal does not even require that a farmer be unable to pay the taxes otherwise due or even be in financial difficulty. In fact, the COD income proposal benefits only solvent farmers, as insolvent farmers are protected under current law.

The proposal does not satisfy the requirement of efficiency because it distorts the market for farm property. It would create an artificial tax incentive for transferring farm property to a lender in satisfaction of debt, even if the property has fair value significantly in excess of the indebtedness. Sale of the property to a third-party at its fair market value and use of the proceeds to satisfy the debt would not trigger the proposal's gain forgiveness, and would therefore be less economically advantageous to the farmer than a transfer to the lender. In addition, the proposal may result in an unintended windfall for lenders because lenders may be able to capture some of the tax benefit through pricing of the transferred property.

The proposal does not satisfy the requirement of administrability because it is exceedingly complex. In addition to the complex annual income tests, to determine whether a farmer qualifies it would be necessary for the farmer and the Service to make an assessment of the farmer's net worth in each year that debt is discharged or satisfied in exchange for farm property.

The proposal would result in substantial revenue loss, and does not include an offset.

V. S. 2202—EXPAND EXCLUSION OF GAIN ON SALE OF PRINCIPAL RESIDENCE TO INCLUDE ADJOINING FARMLAND.

Current law. Section 121 of the Code generally allows a taxpayer who is over 55 to exclude up to $125,000 of gain on sale of his or her principal residence. The exclusion is only available to a taxpayer once. In addition, the exclusion applies only to property used as a principal residence. For example, if a residence adjoins land that is used in a farming business, the exclusion does not apply to the farmland.

Proposal. The bill would expand the section 121 exclusion to apply to farmland sold with a principal residence. If a taxpayer used land adjoining his or her principal residence in an active-farming business, the land would be treated as part of the principal residence for purposes of section 121. The provision would be effective for sales of principal residences after December 31, 1991.

Administration Position. The Administration opposes this provision as structured. As a matter of policy, section 121 should allow exclusion only of gain on residential property, not gain on business property such as farmland. The Administration would, however, consider certain de minimis rules to minimize controversy between the Service and taxpayers concerning the determination of property appropriately included as part of a principal residence.

The proposal would create disparities among similarly situated taxpayers by creating a special "business property" exception for farmers that is not available to taxpayers who use part of their home or land in a business other than farming. There is no justification for such a distinction.

The proposal would also create unjustifiable disparities among farmers. For example, a farmer with gain of $120,000 on his home could exclude $5,000 of gain on adjoining farmland; a neighboring farmer with gain of $5,000 on his home could exclude $120,000 of gain on adjoining farmland; a third farmer with a loss of $100,000 on his home could exclude $225,000 of gain on adjoining farmland (even though the loss on sale of the home would not ordinarily be deductible).

The proposal would result in substantial revenue loss, and does not include an offset.

VI. S. 1130—FAMILY FARM TAX RELIEF AND SAVINGS ACT OF 1991

Current Law. Gain from the sale of farm assets generally is includible in income in the taxable year in which the assets are sold.

Under current law, working individuals generally may contribute a limited amount (e.g., $2,000) per year to an individual retirement account (IRA) on a deductible basis unless the individual either is covered under an employer-sponsored tax-qualified retirement plan or is below certain income thresholds. In addition, employers including self-employed individuals may establish tax-qualified retirement

plans or simplified employee pension plans (SEPs) provided a number of statutory requirements are met. These include minimum coverage requirements and non-discrimination rules. While contributions and benefits under qualified plans and SEPs are also subject to maximum limitations, those limitations are generally substantially greater than the IRA contribution limit.

Proposal. S. 1130 generally would exclude gain from the sale of a qualified farm asset from current income tax to the extent the gain is rolled over to an individual retirement account designated as an asset rollover account (an "ARA"). In general, ARAs would be treated in the same manner as IRAs. As a result, amounts contributed to the account, as well as earnings and appreciation on such amounts, would not be includible in income until withdrawn from the account.

Contributions to ARAs would be subject to an annual limit of $10,000 multiplied by the number of years the taxpayer was a qualified farmer, or if less, the amount of the qualified net farm gain (as defined) for the year. Contributions also would be subject to an aggregate limit of $500,000 in the case of an individual filer. The aggregate limit would take into account other assets held in IRAs to the extent such assets exceed $100,000.

Administration Position. The Administration opposes the proposal.

The proposal is not an efficient means of assisting the survival and success of family farms. It is not limited to small farmers. There are no income or wealth caps relating to its application. The proposal principally assists individuals exiting the business of farming. In addition, the proposal assists financially sound individuals not financially distressed farmers. Financially distressed farmers do not have the capital to invest in ARAs.

The proposal does not satisfy the requirement of fairness. It provides farmers with an alternative retirement savings incentive, without the imposition of the requirements generally applicable to existing tax-favored retirement vehicles or the imposition of comparable limits. Moreover, ARA contributions are only partially coordinated with contributions to other retirement vehicles. Thus, the tax benefit provided to farmers under the proposal potentially exceeds that available to other individuals because it would not preclude farmers from availing themselves of the tax advantages of both the existing retirement vehicles and the ARA.

The proposal also allows large-scale farmers to skirt the non-discrimination rules. When a farmer has employed other individuals in connection with the farming business, the proposal provides farmers with a mechanism for providing substantial tax-favored retirement savings for themselves without the necessity of providing coverage to their employees, as is required generally in the case of other employers who establish tax-qualified retirement plans or simplified employee pension plans in order to contribute on their own behalf.

The proposal would result in substantial revenue loss, and does not contain an offset.

Prepared Statement of William H. Greiner

My name is William H. Greiner. I am the Executive Director of the Iowa Agricultural Development Authority, which is a division of the Iowa Department of Agriculture & Land stewardship. I have held this position since 1980.

I appreciate the opportunity to appear before you today to testify in support of S. 710, sponsored by Senator Charles Grassley, which calls for a much needed permanent extension of tax-exempt Small Issue Private Activity Bonds, commonly referred to as "Aggie Bonds." Iowa has a highly successful Beginning Farmer Loan Program, and the continuance of the program Is dependent on the extension of the sunset date for these bonds.

Iowa was the first state in the nation to offer a program whereby tax-exempt bonds would be utilized to finance qualified agricultural projects. The Authority has operated a program since 1981 under which an individual bond is issued for each loan approved by the Authority board.

The Iowa program is highly targeted in that an applicant for the program must be a "First-time Farmer" under the federal guidelines and a Beginning Farmer under the State of Iowa guidelines. A First-time Farmer is a person who has never owned any direct or indirect interest in substantial farmland in the operation of which he or she has materially participated. A Beginning Farmer is a person who, along with his or her spouse and minor children, has a net worth of $200,000 or less. Projects eligible for financing include agricultural land, depreciable agricultural property, and agricultural improvements including buildings used for agricultural purposes and improvements to land.

It should be noted that one of the important features of the program specifies that, in the event of default on a loan, neither the federal government or the state Authority is liable for any damages. The principal and interest on the bond are payable solely by the beginning farmer and do not constitute an indebtedness of the Authority, the State, or the federal government or a charge against their general credit or general funds. Since the beginning of the program, there have been very few defaults.

Since the first loan was made in Iowa in 1981, the Authority has financed 1,288 loans totaling $109,894,464. Unfortunately, the Authority did not keep a record of the number of acres financed during the first four years of the program, but since 1985, a total of 82,739 acres have been financed. It is estimated that the number of acres financed by the program since its inception is well in excess of 115,000 acres. The calender year 1991 was the best year ever for the Iowa program with 287 loans being closed for a total of $26,373,258. This includes the financing of 23,683 acres of Iowa farmland plus numerous buildings, farm equipment, and livestock used for breeding purposes. Calender year 1992 is off to a very good start with 44 loans being closed thus far totaling $4,178,634. A total of 4,752.37 acres have been financed this year plus buildings, farm equipment, and livestock. The average size loan in Iowa is approximately $86,000.

Other states have experienced similar success with Aggie Bonds. As an example, the Illinois program has been and continues to be highly successful. It issued $11 million in Aggie Bonds in 1991 for a total of more than $131 million since the program started. Colorado issued nearly $10 million in 1991; Kansas, $9 million; Nebraska, $6 million; and Missouri, $4 million. The state of Minnesota started a new program in 1991 and began issuing in the latter part of the year and closed roughly $400,000 in loans. Kentucky was active and closed approximately $600,000 in loans. Other states, including Alabama, North Carolina, Ohio, Georgia, Indiana, Arkansas, and Texas, are trying to activate programs utilizing Aggie Bonds. It should be noted that the state of California is currently considering legislation to initiate a program for the state's first-time/beginning farmers.

The Iowa program has been copied by many other states during the last 10 years and, as a result, more than 4,200 first-time/beginning farmers have been assisted with their purchases of various agricultural projects in these states. Several states are now considering the use of this funding mechanism to assist beginning farmers. However, some states are holding in abeyance any action to develop a program until the extension of the sunset date for Aggie Bonds is acted upon by the Congress.

In Iowa, the largest purchasers of Aggie Bonds are commercial banks. The pricing of the interest rate on these bonds is currently in the range of 75% to 85% of the banks' in-house prime, base, or agriculture real estate rate, and generally falls some two to four percentage points below the conventional rate. The program is also being used more and more by retiring farmers who want to sell their farms on contract to beginning farmers. The interest rate on these transactions is also tax-exempt from Iowa income taxes, which puts these bonds in the 5.50% to 8% interest range.

The question is often asked: "Why would a bank want to purchase these bonds?" There are probably three answers to this question: (1) the bank uses the program to assist a present customer or gain a new customer; (2) the loans under the program qualify under the Community Reinvestment Act (CRA); and (3) the interest income from the bond is not includable in the bank's gross income for federal income tax purposes. I strongly believe that most banks are using the program for reason No. 1—they want to help a customer obtain a loan at a lower interest rate which improves the cash flow projections on the given project.

It must be pointed out that the beginning farmer benefits from this program as well as the bank. However, what is generally not given adequate recognition is the benefit to the local community in which the beginning farmer resides. It is the local community that benefits from the support this funding source makes available to the community's first-time/beginning farmers. It is the local community that will benefit from a better loan afforded a first-time/beginning farmer via the debt structuring provided by Aggie Bonds. The "spinoff economic impact" provided agribusinesses including supply businesses, equipment dealerships, and livestock outlets, is substantial. Schools and retail businesses also benefit from this program. Simply stated, Aggie Bonds have provided a very cost-effective way for lenders to stay within their established credit criteria while, at the same time, actively supporting rural economic development efforts in their community and providing an affordable method of long-term financing for first-time/ beginning farmers.

Iowa, like other midwestern states, is currently facing a dilemma with the exodus of farmers from the agricultural sector. The 1980's were difficult years for farmers in Iowa and other states. We have lost 17,000 family farmers in Iowa since 1980. We have gone from 119,000 farmers in 1980 to 102,000 farmers in 1991. Forty per-

cent (40%) of Iowa farmers are 55 years old or older. A recent survey by Iowa State University showed that as many as 19 percent of those people who are farming today in Iowa are planning to retire within five years. I am sure this phenomenon is also occurring in other farming and ranching states. We must have programs in place that will encourage young people to pursue careers in farming and ranching to replace those who are about to retire. Aggie Bond programs offer a means to help accomplish this objective. Farming is an extremely complex and capital intensive business, therefore, it is vital that programs providing affordable capital be put in place or, in the case of Aggie Bonds, kept in place for beginning farmers.

Iowa is a member of the National Council of State Agricultural Finance Programs. This organization represents a growing 21-state membership from California and Alaska on the west coast to Florida, Georgia, and North Carolina on the east coast. In 1988, the Council conducted a survey of farmers in several midwestern states regarding the use of the program. Seventy-seven percent of the farmer respondents reported that they used this method of financing to make their first land purchase. Sixty-six percent of the respondents indicated they could not have made their land purchase had it not been for the interest savings assistance associated with their Aggie Bond. Possibly the most important finding in the survey was that 96 percent of the respondents noted that by going through the process of obtaining Aggie Bond funding, an excellent relationship was developed with the local loan officer of the bank . . . a resultant relationship with long-term positive ramifications. The survey also revealed that over 75 percent of the users of Aggie Bonds were small independent community banks.

In summary, Aggie Bonds are providing an affordable means for first-time/beginning farmers to finance their first land purchase or other assets to assist them with their farming enterprise. The most frequent user of the program in Iowa is a couple who has farmed for 3 to 10 years, has built some equity in machinery and livestock, and is using the program for their first land purchase. Aggie Bond programs allow lenders to structure loans for beginning farmers in a manner that is consistent with the farmer's ability to satisfactorily repay principal and interest on the debt.

Aggie Bond programs are plagued by the constant threat of termination. There have been four sunset dates for Aggie Bonds in the federal tax code in recent years—December 31, 1989; September 30, 1990; December 31, 1991; and June 30, 1992. I submit that working around these sunsets is a waste of precious time by the various Authorities administering these programs, the lenders and borrowers using the program, and certainly Congress expends too much time contemplating the extension of this type of financing each year. We all need to direct our creative energies toward making the programs better and more usable rather than debating the sunset issue each year. We need the help of this subcommittee to support S. 710 to remove the sunset date for Aggie Bonds entirely.

Aggie Bonds work and are being used for the purposes intended by Congress and the General Assemblies of the respective states using the program. I again encourage you to support S. 710 to permanently extend the sunset and allow Iowa and other states to go forward with our mission of assisting first-time/beginning farmers with their credit needs. The country will be a better place as a result.

Thank you for the opportunity to present this statement for your consideration.

Prepared Statement of James H. Harris

I wish to thank you, Senator Daschle, for the opportunity to testify on behalf of the American farmers. We strongly endorse Senator Hasten's Bill S. 1130 titled "FAMILY FARM TAX RELIEF AND SAVINGS ACT OF 1991" and other similar bills that have been presented by members of congress.

For brevity, the bill may be referred to as "F-RA," standing for FARMERS RETIREMENT ACCOUNT in this presentation.

"F-RA" re-establishes the farm assets as the Farmers Retirement Fund correcting the hardships caused by:

1. The capital gains tax revisions of 1986 and
2. The oversight or failure to recognize that the farm investment unit does satisfy the intent and criteria for investment of funds required of the IRA concept.

LIMITS—There are definitely limits to F-RA. A few follow:

1. Full time farmer for minimum of 5 years to qualify.
2. Maximum of $10,000/year of farming per spouse.
3. Maximum of $500,000 lifetime contribution limit per farm couple.
4. One's ability to pay—I lost about $17,000 last year on the farm and had no significant charges for interest or depreciation.

5. All other existing IRA'S are limited to $100,000 total. (The 401Ks, Keoughs, IRA'S or multi-million dollar accounts which can achieve values of hundreds of millions of dollars.)

The bill is unique in that it neither advantages or disadvantages any farm region, product or activity. It will provide great incentive for substantial long term investment commitment to rural America. Also to the farm unit because the farmer can, without reservation, devote all assets to the farm development, keeping his retirement funds at *home!* (not Texas S&L's or South Africa gold mines.)

The bill recognizes the need of the special farming (tenant farming) situations which hold *little* or *no real estate* but have large investments in crops, animals, machinery, etc. To date most long term tax advantages have been targeted at real estate holdings not working assets.

OBJECT:

TREAT A PORTION OF THE FAMILY FARM ASSETS AS A "SELF-DIRECTED" IRA WITH INCOME TAX DEFERRAL, ROLLOVER AND MAKE-UP PRIVILEGES COMPARABLE TO THOSE GRANTED TO OTHER TAX PAYERS' SELF-DIRECTED IRA'S.

FACT—Farming is an extremely capital intensive profession-occupation. Long term growth and success of a family farm requires all of the farmer's capital resources. One dollar of farmer income yields $.10 to kitchen, $.90 to bank to borrow $10 more, leaving nothing to invest in IRA'S or significant social security.

FACT—White/blue collar workers and other professionals, make large incomes that require little capital outlay.

FACT—These people are allowed generous tax preferential treatment of large sums invested in retirement —packages—IRA's, 401K's, Keoughs, Deferred Comps., employer paid retirement funds, etc., which are *invested in commerce. LET THE FARM BE THE COMMERCE FOR THE FARMER'S IRA.* IT CERTAINLY SATISFIES THE INTENT AND PURPOSES OF IRA'S. It is simply an investment vehicle like savings, stocks, bonds, mutual funds, etc.

FACT—Throughout history the farmer's capital appreciation was the farmer's retirement fund and was given tax preferential treatment by means of the previous long term capital gains tax exemption. Capital gains accumulated by a family's hard labor on the farm certainly deserves more consideration than stock market poker money. Genetics of the farmer's dairy herd is family developed from grandparent to grandchild and the farmer is a very active—not passive—risk participator. Plus a major investor in the infrastructure of rural America.

FACT—Now when a farmer is forced or voluntarily sells out (farm auction) when retiring, all proceeds are taxed at a high tax rate, as if ones lifetime—blood and sweat—assets were earned that year (no consideration for inflation.) Paper stocks gains are easily held and averaged for retirement years, *agricultural assets—impossible!!!*

When net farm income is limited or nonexistent due to the combination of persistent low prices and required capital expenditures, *by law,* NO TAX EXEMPT IRA'S AND ONLY *LIMITED* SOCIAL SECURITY CAN BE FUNDED. Result—IRA'S and meaningful Social Security are unaccessible for many farmers. Thus, the farmer retires with slim retirement funds and a retirement to poverty. YET, the government demands their "PINT OF BLOOD" out of the capital gains area of the farm sale.

A VERY TINY FRACTION OF THE S&L FIASCO COST WOULD PERMANENTLY ENDOW A *RESPONSIBLE* FARM F-RA PROGRAM!! Agriculture is a most essential "PUBLIC UTILITY" and it's health must be regarded as vital to society. Farmer's capital is invested locally—not S&L's or South Africa—giving a local return of 6 to 1, creating local tax base and jobs.

Forms of this resolution were passed, or in process by *many farm organizations.*

The typical annual retirement package available of $10/hr. to $12/hr. Wisconsin state employees (my wife's) is (1) $3,000/yr. employer paid retirement; (2) $2,300 employer paid S.S. (7.65% vs. 15.3%); (3) $7,500 shared or self paid 401K (with a $22,500 hardship make up privilege); (4) $2,000 self-paid IRA; TOTAL $14,800; (5) + employer paid health insurance; (6) + equal spouse's IRA account. The $500,000 limit of Farm F-RA bills cost $63.80 per month, per farm couple, while the $2,000.00 IRA bills cost $333.32 per month per couple and achieve a value of $2,608,000 and Senator's Kennedy and Bradley say this is an unwarranted raid on the U.S. Treasury??? especially after the midnight fiasco of July, 91!

I could go on and on on the unfairness issue. If one must, take some away from the over-endowed so us under-endowed can spend a few years in dignity before we turn to the county for support and welfare assistance.

A farmer's Social Security is much less than one would think. Also, seldom is there a separate Social Security account for the farm wife.

This F-RA concept is of unique value only to those professions which have a huge "RATIO" of required capital assets per dollar of net earned income, particularly where every possible dollar must go back into the business and one absolutely cannot afford a separate retirement fund.

***Presently one spouse almost needs to die so the other can retire comfortably, benefiting by new cost basis established by the spouse's death—SAD!

A HYPOTHETICAL "½" OF AN ALLOWED IRA—EXAMPLE

INPUT $1000.00/YEAR RATE OF $1000.00/12 MO.=$83.33 PER MO. INTEREST 8% PER ANNUM—COMPOUNDED MONTHLY

Time		Account total	Monthly interest paid
Mo.	Years		
1	1/12	83.33	0.55
12	1 YR.	1,031.17	6.31
120	10 YR.	15,145.09	100.41
240	20 YR.	48,760.52	324.51
360	30 YR.	123,374.72	821.94
480	40 YR.	289,991.36	1926.05
600	50 YR.	652,170.52	4347.24
560	46⅔	*$500,456.55*[1]	3335.82

[1] Less than 47 years of $83.33 monthly deposits accumulate to an excess of the $500,000 asked for in the "F-RA" bill.

The above table along with other data was used to construct the "IRA" and "F-RA"—Time Curves.

DISCUSSION OF THE SIMPLE LINEAR GRAPH NO. 1

When one reviews Curve No. 1 of graph I we see that an annual deposit of $1,000 deposited at a monthly rate of $1,000/12 months or $83.33/month grows to $652,170.00 in 50 years. A deposit of $766/year ($63.80 per month) deposited monthly with 8% [1] compounded monthly interest achieves our $500,000 goal. Since we may have a working couple and each contributing to full $2,000 IRA'S ($4,000 total—Curve III), then the combination would grow to $500,000 in a mere 30 years, not 50 as specified in "F-RA" bill. The data is repeated on semi-log scale graph paper (graph 2) which compresses the huge account totals to a scale of which they can be visualized.

Now consider my brother John Harris—a Case I-H Tenneco employee of 29 years and is 57 years old. He has a company package of:

I. 401K—The Company and he each contribute 8% of his salary—Input value approx. $12,000/year

II. IRA—$2,000 (self paid)

III. Company paid retirement plan—Retirement:

At age 57 per month $1,600
At age 62 per month $2,500

IV. Social Security ½ paid by Co. approx./yr $3,200

V. Deluxe Co. paid health insurance throughout working and retirement years (and the govt. don't even want ours to be deductible.) $8,000/year

This package is worth many, many millions of dollars compared to the pittance of the cost of "F-RA'S" $383.00 per year per spouse.

ACKNOWLEDGEMENTS

I wish to acknowledge and commend Senator Kasten for his leadership on the "F-RA" legislation and also the support of Racine County, Walworth County and Kenosha County Farm Bureaus and Jack King of the American Farm Bureau; Darlene Ehrhart of Racine County Farm Bureau, and most of all my wife Nelda for the support needed to carry this project forward.

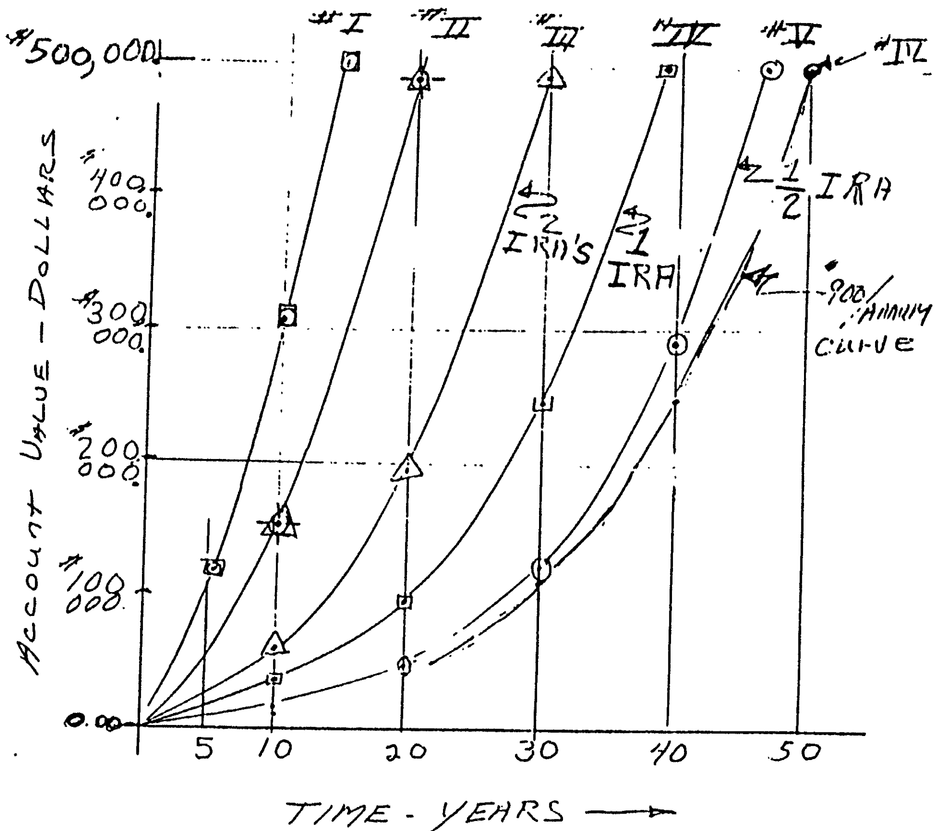
Please contact James H. Harris, 4001 67th Drive., Union Grove, WI 53182, for answer to any questions.

[1] Farmers have commonly paid 12 to 18% interest on their loans for the last 20 years.

Graph - IRA Account - Total Dollars
VS
Time - Years 4-28-92

INTEREST - 8% per annum -
Compounded & paid monthly

CURVE			50 YR. VALUE
I	$20,000.00/yr.	($1667.00/mo.)	$13,043,400
II	10,000.00/yr.	(833.33/mo.)	6,521,170
2 IRAS = III	4,000.00/yr.	(333.33/mo.)	2,608,680
1 IRA = IV	2,000.00/yr.	(166.67/mo.)	1,304,340
½ of IRA = V	1,000.00/yr.	(83.33/mo.)	652,170



GRAPH I

SEVEN ACCOUNT TOTALS IN DOLLARS FOR EQUAL MONTHLY DEPOSITS @ 8% INTEREST COMPOUNDED MONTHLY

TIME IN YEARS	VARIOUS ACCOUNT TOTALS VS TIME						
	2-401K'S PLUS 2-IRA'S	1-401K PLUS 1-IRA	2-IRA'S (MAN & WIFE)	I IRA	1/2 IRA	1-F-RA (FARMER & SPOUSE)	1/2 F-RA
1/12	20,000 / 12	10,000 / 12	4,000 / 12	2,000 / 12	1,000 / 12	766 / 12	383 / 12
1	20,620	10,310	4,124	2,062	1,031	790	395
10	302,900	151,450	60,580	30,290	15,145	11,500	5,750
20	975,200	487,600	195,000	97,520	48,760	36,800	18,400
30	2,467,000	1,233,000	493,000	246,748	123,374	94,300	47,150
40	5,800,000	2,900,000	1,160,000	580,000	289,991	221,000	110,500
50	13,043,000	6,521,000	2,608,000	1,304,000	652,170	500,000	250,000
PER MONTHLY DEPOSIT OF	1,666.66	833.33	333.32	166.66	83.33	63.80	36.90
50 YEAR ACTUAL TOTAL CASH INPUT	$20,000. x50 = 1,000,000	$10,000. x50 = $500,000	$4,000. x50 = $200,000	$2,000 x50 = $100.000	$1,000 x50 = $50,000	$766. x50 = $38,300	$383. x50 = $19,150
MAXIMUM ANNUAL WITH-DRAWAL @8% @ YR 50	$ 13,043,000 x.08 = $1,043,440.	$ 6,521,000 x.08 = $521,680.	$ 2,608,000 x.08 = $208,640.00	$1,304,000 x.08 = $104,320.	$652,170 x.08 = $52,173.50	$500,000 x.08 = $ 40,000	$250,000 x.08 = $ 20,000

When one considers that the "F-RA" people have essentially no other benefits where the million dollar people are loaded with perks and if you could be so kind as to read the enclosed President's letter, then your conscience will dictate a "yes" vote. Refer to attached "USA TODAY" and USDA letter.

AMENDMENT I

RACINE COUNTY FARM BUREAU

1701 Main Street
Union Grove, Wisconsin 53182
(414) 878 2418

December 30, 1991

President George H. W. Bush
The White House
1600 Pennsylvania Avenue N.W.
Washington D.C. 20500

Subject: "F-RA", FARMERS RETIREMENT ACCOUNT, re-establishes farm assets as the farmers retirement fund, partially negating the disasterous effects of the 1986 tax treatment of capital farm assets. Refer your address to American Farm Bureau Federation, Monday, January 13, 1992.

Dear Mr. President,

This is an urgent plea to you, to take action in addressing a very serious problem we "senior" farm people have. IT IS VERY MEAGER RETIREMENT FUNDS and very little social security coverage.

The upcoming American Farm Bureau Convention (January 12-16 - Kansas City), which you are addressing, would be an ideal situation for you to reaffirm your concern for the farmer by announcing your full support for "F-RA".

I have devoted six years of my life in trying to develop equal treatment and access to IRAS for farmers. "F-RA" does this, nothing more - nothing less.

The effort has resulted in two (2) house and one (1) senate "F-RA" bills (all by Wisconsin legislatures). Two Wisconsin Senators and 8 of 9 Wisconsin Congressmen are on as sponsor/co-sponsors. I am now assisting Wisconsin State legislative bodies in drafting similar state bills.

Senator Bob Kasten readily recognized the merits of the concept by introducing S 1130, Sensenbrenner HR 2470 and Moody HR 2333, giving bi-partisan support.

Housestaffers have criticized me for not seeking administration support. We fully understand your concern for holding budget costs. The farmer paid the off-setting cost in full in 1986 when he lost his retirement fund through the capital gains revision.

We are the group who fed the country and a good portion of the world through Vietnam, Korea, World War II, depression

years, and yes, a few go back to World War I. We provided billions upon billions of dollars of ag exports yearly to the U.S. Treasury for over a half century. Now a decade of hard times, poor prices and a capital gains tax revision are bringing us senior farmers to beg for fair IRA treatment.

Tens of thousands of us are too old or too crippled to farm any longer and need and want to retire but don't have the funds to do so. Help us!! You wouldn't believe the financial distress stories I have been told by our senior farmers since working on "F-RA".

The financial demands of day to day farming are so great there is small chance for a profit, hence little social security benefits, no separate IRA'S, no company fringes (health insurance, retirement, 401K's). Many are destitute and try to farm long after they are physically capable of doing so.

Thank you Mr. President for considering this matter. I hope to see you in Kansas City wearing the enclosed "F-RA" button.

Sincerely,

James H. Harris, Chairman
National and State Affairs
Racine County Farm Bureau

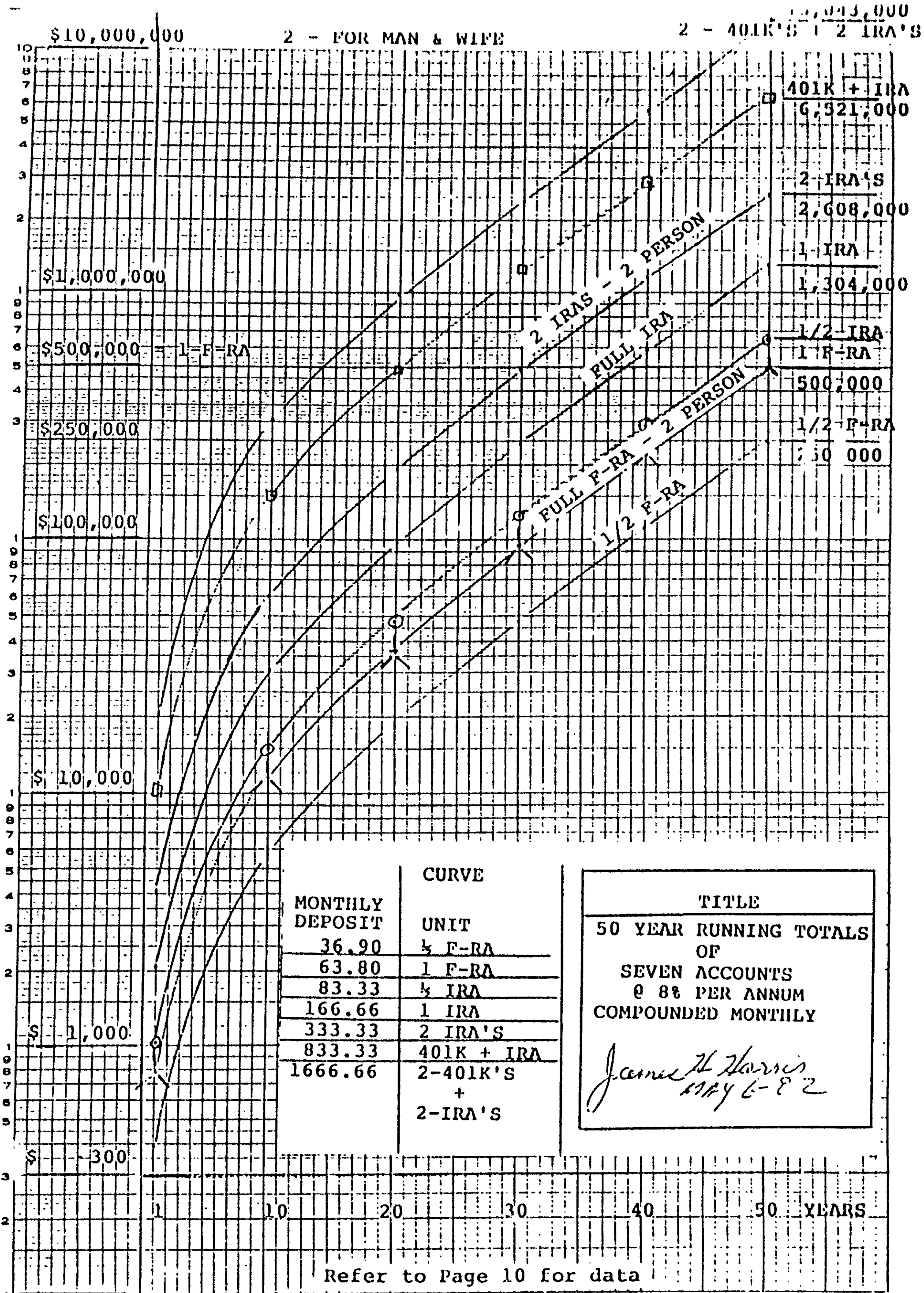
JHH:de
Enc:

PS: The American consumer pays between $.02 to $.04 per meal to support a 5.5 to 11 billion dollar farm program (250 million people - 3 meals a day). In return, he is assured of the world's cheapest, most plentiful food and fiber supply. Some bargain??

In two working days a farmer provides a consumer a years food and fiber needs but yet can't afford to feed and clothe his family. Poor efficiency is not the problem, obviously poor prices are!!

Please review the enclosed "F-RA" sheet carefully as it is a supporting document.

*** Presently one spouse almost needs to die so the other can retire comfortably benefiting from new cost basis established by the death - SAD!!



GRAPH II

EUGENE DIETZGEN CO.
SEMI-LOGARITHMIC
5 CYCLES X 10 DIVISIONS PER INCH

Arbitration case's lesson: Let investor beware

Column I

NEW YORK — Three retired Procter & Gamble workers will sit down next week at what is shaping up to be a bitter Wall Street arbitration hearing. If their allegations are true, the case provides a textbook example for the average investor in how not to make investment decisions.

WALL STREET
By Susan Antilla

And it serves as a reminder of how vulnerable retirees are to being put in the wrong investments.

USA TODAY has obtained copies of the retirees' complaints and the written response of First Investors, a mutual-funds firm. The plaintiffs contend a First Investors broker put their lump-sum retirement checks into high-risk junk-bond mutual funds without explaining the risks, all the while assuring the investors their money was guaranteed up to $500,000. First Investors says no such guarantee was given and the investors could have read the prospectus. But a profile of the plaintiffs hardly describes the sophisticated investor who could successfully wade through difficult prospectus jargon.

Column II

The complaining customers:

▶ A 65-year-old former P&G welder who also worked on the soap-production line where Tide detergent boxes were filled. He had a 10th-grade education. His wife, 65, had an eighth-grade education. She, too, worked on a P&G production line. They invested their combined $520,000 lump sum in 1986 and claim to have lost $256,356 plus interest.

▶ A 63-year-old ex-P&G boiler-room worker. After he retired in 1988, he invested $250,000 of his $267,000 lump-sum check in a junk-bond fund. By the time his financial troubles forced him to yank his daughter out of college in February 1990, he claims to have been out $83,956.

▶ A 41-year P&G veteran who worked on a production line until his retirement in 1985. The claimant, who says he lost $113,512 plus interest on his $300,000 investment, had a fifth-grade education. Like the other plaintiffs, he says he was assured the junk fund was safe and guaranteed up to $500,000.

Column III

The plaintiffs already were vulnerable because of their lack of sophistication about finances. Each had an additional risk to being wooed because they knew and trusted the broker. The main defendant in the case is a First Investors broker who also had prepared annual income taxes for all the plaintiffs.

That's all the more reason for the broker to have known that junk bonds were not the right investment for the retirees: He was intimately familiar with their financial status. First Investors, in its written response to the charges, says the retirees specifically asked for a product with a high interest rate. First Investors lawyer Glenn Reichart of Washington firm Kirkpatrick and Lockhart said he would not comment beyond saying he expects to resolve the case "in a way that is favorable to First Investors."

First Investors tells its side of the story in a statement it filed with the National Association of Securities Dealers, which will begin hearing the case Tuesday. The company says industry analysts did not consider junk bonds to be risky in 1987. First Investors also says the broker suggested that one client put his money into bank certificates of deposit, but the customer wanted

Column IV

higher income than a certificate of deposit would provide.

Everyone can learn a lesson from investors who make such giant mistakes. No matter who steers you to an investment and no matter how long you've known that person, you need to do some work before you can have real peace of mind. Staying up on business news would have alerted the plaintiffs that junk bonds were risky. In the First Investors case, unfortunately, the term "junk bonds" allegedly was not used, so it's questionable whether the plaintiffs could have figured it out, considering their educational and work backgrounds. Had the pitch been made today, they could have called the North American Securities Administrators Association in Washington to get a rundown of the broker's disciplinary record, though. And they might ask bosses at their former employer for recommendations of reputable brokers who *might* take care of their investment needs.

You'd ask your friends and colleagues how they liked their new Ford or Chevy before you'd plunk money down for a car. Kick your broker's tires, too. And keep looking if you hear the hot air hissing out when your foot makes contact.

Column V

First Investors script: 'Objective is to close the sale'

Ever wonder how hard-pitching brokers come up with great arguments? Take a peek at the script First Investors brokers work from:

▶ "Some of our clients set aside money for a college fund. Do you have any children, Mr. ———? (If so, get names and ages.) Some of our clients set aside money as a retirement nest egg or to buy a new home or for an emergency fund or to take that trip around the world."

▶ "Of course, Mr. ———, I can understand why you would want a guarantee; so let's look at something together. The thousands of people who invested the millions of dollars (so far in our funds) also wanted a guarantee and they invested some of their money in Fund for Income because they realized that the corporations in the portfolio, such as ———, guarantee to pay both principal and interest backed by the full extent of their assets."

From a section of advice to brokers on closing a sale: "The objective is not to overcome all objections; the objective is to close the sale.... The objective is not to educate people to encourage them to shop; it's to involve people to encourage them to sign."

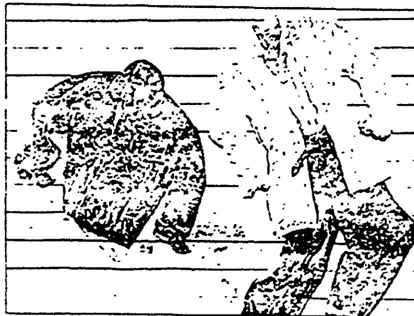
Keds takes on Gap with line of women's clothing

By Ellen Neuborne
USA TODAY

Can a little red sneaker grow up to be a snazzy fashion statement? Keds thinks so.

The familiar sneaker maker is lending its name to a new line of women's clothing. The venture, Keds Apparel, is taking on a formidable competitor: The Gap. "Everyone talks about the strength of The Gap, and they are fabulous. But they have a weakness," says Tommy Hoffman, president of Keds Apparel. "They have the label 'basics.' They are the 7-Eleven, the butter and eggs. They don't have a strong fashion identity."

Hoffman is banking on the idea that giving similar clothes a fitted look will appeal to older



OLDER APPEAL: Keds' clothes will have a fitted, tailored look

blazers and baseball caps.

Among department stores signed up to try Keds: Dillard stores in St. Louis; Federated Department Stores, including Jordan Marsh and Lazarus; and Hudson's Bay in Toronto. A $3 million television ad campaign is in the works.

Hoffman says the high recognition of the Keds brand name will be enough to set his line apart in the crowded women's casual market. But John Morton, who tracks brands for Total Research, says the Keds name might be passe.

"For a successful brand extension, the brand must have prominence. I'm not sure that's true here," he says. "Keds was a very prominent brand 20 years ago. But the Keds I remember

have been wiser to stick closer to its playful, childhood image.

"Keds, in my mind, brings up the image of kids. I see a logical link between Keds and a line extension into children's clothes," Totterdale says. "The connection between Keds and women's clothing to me is not a strong one."

Hoffman says Keds revenue will near $35 million its first year, growing to $250 million a year in five years.

The real test will come when the clothing hits the market and consumers tell Keds and its critics who's right.

"Other boutique stores have been big hits for department stores — Swatch, Ralph Lauren. They've been good for department stores," says Chris

Guide to the Stock Hot Line

1. Call 1-900-555-5555, 24 hours a day, every day for quotes on stocks listed on the New York, American and NASDAQ national exchanges. Cost: 95¢ per minute. (Quotes during trading hours are delayed 15 minutes from the time of the actual trade). After reaching the USA TODAY Information Center, press 2 to connect with the Money Hot Line and press 1 for stock quotes. You can select stocks for quotes either by name (press 1) or by ticker symbol (press 2).

2. To select stocks by name, spell each stock's name using the letters on your telephone's keypad. You can spell the formal name of the company, for example, [illegible] rican Express or General Motors. Or you can use the abbreviated [illegible] ng that appears in USA TODAY's stock listings, for example AmEx [illegible] GnMotr. (Don't enter any adjoining footnote letters such as wt, wi, v, n, [illegible], etc.) And, for the 1,000 largest companies, you can spell the commonly used name, for example Amex or GM. The letters Q and Z don't appear on the keypad, so skip them. Skip spaces between words, too. Always press # after you enter each stock.

3. To select stocks by ticker symbol, use the table below to convert your stock's one- to five-letter ticker symbol into numbers. Then enter those numbers and press #. For example, to enter the ticker symbol for American Express, AXP, press 21-92-71-#. Always press # after you enter each stock. Ticker symbols can be obtained from a stockbroker, the company or one of the stock guides found in local libraries.

4. You can switch from names to ticker symbols by pressing #2 at any time, or from ticker symbols to names by pressing #1 at any time.

5. You can get quotes for preferred stocks and warrants only by using the ticker symbol. Enter the numbers corresponding to the ticker symbol, then press 12 and # for preferred or 11 and # for warrants. For Avon Products preferred stock, for example, enter the numbers for the Avon ticker symbol (AVP), then 12, then # or 21-83-71-12-#.

6. You can move on to your next selection at any time. You need not

AMENDMENT III

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

> This letter from USDA outlines concepts that may have merit for the economy in general. However, these concepts are pathetic in value for most farmers. If we can't afford to contribute at $10,000 level what value is a $120,000 limit. Our farm investment is assessed in our local tax base and local economy (jobs, schools, roads, infrastructure, etc.) Not $500,000 IRA'S a half continent away in Texas S & L's, Japanese, German, South African stock markets.
> USA Today, February 27, 1992 issue* (see back of sheet) writes of common U.S. production plant workers at Proctor & Gamble rolling over $260,000 to $300,000 each (or $520,000 per couple) in retirement funds at retirement age and losing it in junk bonds to Boesky-Milikin etal. Why can't the farmers mandated investment qualify as an IRA. There are landless tenant farmers too.
>
> Mr. President, is this fair? The farmer has been your friend.
> Jim Harris

Mr. James H. Harris
Chair
National and State Affairs
Racine Country Farm Bureau
1701 Main Street
Union Grove, Wisconsin 53182

Dear Mr. Harris:

Your letter to President Bush concerning a farmer retirement fund has been forwarded to my office in the Department of Agriculture for reply.

Your concerns regarding the high tax rate on capital gains and the need to encourage savings for retirement and other purposes are addressed in the recently unveiled 1993 budget. In the budget, the President proposed cutting the tax rate on long-term capital gains. Under his plan, 45 percent of the gain from the sale of qualified assets held at least 3 years would be excluded from income. Farmland, buildings, equipment, and certain livestock would qualify for the exclusion. As a result, the Federal tax liability associated with the sale of these assets would be greatly reduced. This should increase the net proceeds from the sale of farmland if it is used as a source of retirement income.

In addition to restoring a reduced tax rate for capital gains, the President has proposed expanding the availability of individual retirement accounts (IRAs). Currently, married taxpayers who participate in a qualified retirement plan and who have adjusted gross income above $50,000 cannot make deductible contributions to an IRA. Under the President's proposal, married taxpayers could contribute up to $2,500 to a flexible IRA account as long as their adjusted gross income is below $120,000. The contributions would not be deductible. However, if they are retained in the account for 7 years, neither the contributions nor the investment earnings are taxed when withdrawn. This would expand the availability of IRAs for farmers as well as other taxpayers.

Sincerely,

Daniel A. Sumner
Acting Assistant Secretary
for Economics

> Besides the funded $250,000 plus IRA, these people's retirement probably include I. Company paid retirement plan (elected officials $100,000 per year?) II. Co. paid lifetime family health plan (taxed?) III. Because of amount of IRA - Must be getting maximum S.S. (not a couple of $100/mo.). IV. S.S. costs only 1/2 of that of the self employed. V. Plus. an on going high living standard.
>
> Jim Harris

MONEY

Farm retirement-funds proposal before Congress

■ Beef and grain producer Jim Harris, 61, wants to end the old adage that farmers live poor and die rich.

For six years, the Wisconsin farmer has been rounding up support for amending federal tax law to permit farmers to roll over sales of land, machinery or livestock into self-directed Individual Retirement Accounts. Harris, who has spent nearly $8,000 pushing the idea, prefers to call them Farmers Retirement Accounts (FRAs).

Rather than pay 28% capital-gains taxes, as well as state taxes, after asset sales, farmers would defer taxes with FRAs until they begin withdrawing funds after retirement. A farmer and spouse would roll over $500,000 per couple, or $10,000 for each year up to 25 years that both spent farming.

Harris, who worked as a corporate engineer and consultant while farming in Racine County, Wis., got the idea when Congress passed the 1986 tax reform, wiping out the special capital-gains tax. For four years, he got little notice as he tried to push his idea through the Wisconsin Farm Bureau. Finally, he got the proposal included in resolutions passed at the 1991 American Farm Bureau Federation convention. The National Farmers Union and National Farmers Organization also got on board.

A big break came when Harris presented his idea to Sen. Robert Kasten (R., Wis.) as the senator headed to a meeting. After walking just 50 ft., Kasten told Harris: "I'll introduce that for you tomorrow."

Later Rep. Jim Moody (D., Wis.) let Harris and a neighbor stay in his two guest bedrooms for a week while they worked out details of a House version. Rep. James Sensenbrenner (R., Wis.) introduced a bill as well.

Now lawmakers are gathering cosponsors (49 so far), waiting for a cost estimate from the Congressional Budget Office and hoping to attach it to a tax bill this year.

WHEN TALKING ABOUT retirement funds, 40-year-old farmers ignore Jim Harris because they think they will "live forever and die rich." Fifty-year-olds are mildly interested. "You get a guy over 60 and you can't get away from him," says Harris.

Contributing to this page:
Sonja Hillgren and Mary Thompson

Mr. Harris goes to Washington

...attleman makes progress with his ...arm capital gains tax ... bill

By Jim Kneiszel
...ashington Bureau Chief

...NION GROVE — Things turned a little differently when Mr. ...rris went to Washington.

...immy Stewart once portrayed a ...all town man of conviction who ...nd the halls of Congress filled ...h untrustful scalawags in the ...vie, "Mr. Smith Goes To Washington."

...ut when local beef and grain ...mer James Harris went to the ...on's capital this spring with an ...e close to his heart, Congress... told him to pull up a chair and ...down to the business of writing ...own legislation.

...ne of those public servants, Rep. ... Moody, D-Milwaukee, went as ...as to invite Harris and farming ...ghbor Bill Howell to stay at his ...shington home to cut the cost of ...ir trip east.

...arris also left his mark on ...shington, with hard-nosed politi... types lauding his persistence as ... perfect example of what a democratic government is all about.

Moody's chief of staff, Marcus Kunian, said Friday that the single farmer accomplished on his own what countless professional lobbyists could not.

During that five-day visit in which the farmers dined with Moody and worked with his staff, the men crafted the guts of a farm capital gains tax relief bill which is being submitted to the Senate and the House for consideration.

The bill would allow family farmers to sell their businesses and roll the proceeds over into individual retirement accounts. Currently, farm sales are taxed at the regular income tax rate, usually 28 percent. Farmers historically have counted on using the sale of their farms for retirement income, Harris said.

Because farmers generally turn all their profits back into the business, they seldom have money to start their own IRAs, Harris said.

(Please turn to HARRIS, Page 2A)

Mark Hertzberg/Journal Times
Cattle and grain farmer James Harris with one of his Angus steers.

(Continued from Page 1A)

They also don't have the variety of investment opportunities open to employees of corporations, he said.

The 61-year-old farmer considered it a matter of fairness that farmers should not be forced to pay high taxes when selling a family business they have nurtured for a lifetime and counted on for security.

After the tax bill of [illegible] wiped out previous capital gains tax exemptions for everyone, including farmers, Harris began stumping for a farm exemption by "bending elbows" with congressional aides at county fair booths all over southeast Wisconsin.

After Harris promoted the idea for five years, it had been endorsed by 30 state Farm Bureau delegations, including Wisconsin, and the National Farm Bureau in [illegible]. But it was still lost in a sea of about 1,000 other Farm Bureau resolutions, and Harris feared it wouldn't get the attention he thought it deserved.

"Unless somebody is going to make it a pet goal, nothing is going to happen. So I took it," Harris said. "I've felt for some time that the farmers are taking the short end on many issues, and this is one."

Harris has spent between $3,000 and $4,000 of his own money to promote the capital gains tax reform for farmers, and has juggled his lobbying effort with operating his 180-acre farm with about [illegible] beef cattle at 4001 67th Drive.

With the support of the Racine County Farm Bureau and other farm organizations, Harris has twice walked the halls of Congress, handing out leaflets about his idea and talking to as many politicians as he can reach. In early March, Moody talked to him for 20 minutes about the idea, and many other congressmen were interested.

A week later, Moody called Harris and invited him back to work with aides on writing his resolution. After hearing Harris was on a shoestring budget, Moody invited him to stay in his Washington home.

Harris was also helped by Sen. Robert Kasten, R-Wisconsin, who has written a Senate bill based on the farmer's ideas. Kasten's bill is being circulated for co-sponsors, while the House resolution is going to be studied by the Ways and Means Committee.

Many people might have good ideas for government, but Harris' determination to go to Washington and change things set him apart from everyone else, Kunian said.

"He's just a really remarkable guy. He really made this thing happen," Kunian said. "This is really an extraordinary example of the best of a representative democracy is supposed to be about. Here's a guy who has an idea he's been promoting for a number of years. Through sheer persistence, he is able to develop this."

"Somewhere there is a quarter-million dollar lawyer with sixteen secretaries in a think tank trying to think of ways to save money for farmers. We can ring him up and tell him not to worry about it. We've got Jim Harris."

> "Somewhere there is a quarter-million dollar lawyer with sixteen secretaries in a think tank trying to think of ways to save money for farmers. We can ring him up and tell him not to worry about it. We've ...t Jim Harris."
>
> — Marcus Kunian
> chief of staff for Rep. Jim Moody

NON REGIONAL - NON CROP SELECTIVE - NON ANIMAL PREFERENCE - HURTS NO FARMER - EQUALLY BENEFICIAL TO EVERY FARMER - PROBABLY CONSIDERABLY MORE BENEFICIAL AND OBTAINABLE THAN ANY CAPITAL GAINS BILLS WILL EVER BE - IT IS WORTH BETWEEN TENS OF THOUSANDS TO HUNDREDS OF THOUSANDS OF DOLLARS FOR MOST FARMERS IN RETIREMENT SAVINGS - RESULTS ARE A RETIREMENT WITH MORE FREEDOM, DIGNITY AND LESS FINANCIAL STRESS - MAY WELL CONTRIBUTE TO REDUCED FARM PRODUCTION AND HIGHER FARM INCOME.

RACINE COUNTY FARM BUREAU

12/3/91

Please contact:
JIM HARRIS, CHAIRMAN
Racine County Farm Bureau
National & State Affairs Committee
4001 67th Drive
Union Grove, WI 53182

414-878-1663

SUPPORT & FINANCIAL ASSISTANCE NEEDED

1701 Main Street • Union Grove, Wisconsin 53182 • Telephone 414/878-2418

*** F-RA - FARMERS RETIREMENT ACCOUNT ***

Bills: KASTEN (R-WI) S 1130 MOODY (D-WI) HR 2333 SENSENBRENNER (R-WI) HR 2470

TREAT A PORTION OF THE FAMILY FARM ASSETS AS A "SELF-DIRECTED" IRA WITH INCOME TAX DEFERRAL, ROLLOVER AND MAKE-UP PRIVILEGES COMPARABLE TO THOSE GRANTED TO OTHER TAX PAYERS' SELF-DIRECTED IRA'S. FAIR TREATMENT AND ACCESSIBILITY TO RETIREMENT ACCOUNTS FOR FARMERS IS PAST DUE.

FACT - Farming is extremely capital intensive profession-occupation. Long term growth and success of a family farm requires all of the farmer's capital resources. One dollar of farmer income yields $.10 to kitchen, $.90 to bank to borrow $10 more.

FACT - White/Blue Collar workers and other professionals, make large incomes that requires little capital outlay; Doctors, Lawyers, Salesman, Factory Workers, etc.

FACT - These people are allowed generous tax preferential treatment of large sums invested in retirement packages - IRA, 401 K, Keough, Deferred Comp., employer paid retirement funds, etc. which are invested in commerce. LET THE FARM BE THE COMMERCE FOR THE FARMER'S IRA.

FACT - Throughout history up to the tax reform Act of 1986, the farmer's capital appreciation was the farmer's retirement fund and was given tax preferential treatment by means of the previous long term capital gains tax exemption. Capital gains accumulated by a family's hard labor on the farm certainly deserves more consideration than stock market poker money. Genetics of the farmer's dairy herd is family developed from grandparent to grandchild and the farmer is a very active-not passive - risk participator.

FACT - Now when a farmer is forced or voluntarily sells out (farm auction) when retiring, all proceeds are taxed at a high ordinary income tax rate, as if ones life time assets were earned that year (no consideration for inflation). Paper stocks gains are easily held and averaged, agricultural assets - impossible!!!

When net income is limited or nonexistent due to the combination of persistent low prices and required capital expenditures, by law, NO TAX EXEMPT IRA'S AND ONLY LIMITED SOCIAL SECURITY CAN BE FUNDED.

Thus, the farmer retires with slim retirement funds and a retirement to poverty. YET, the government demands their "PINT OF BLOOD" out of the capital gains area of the farm sale.

COST OF THE S&L FIASCO WOULD PERMANENTLY ENDOW A RESPONSIBLE FARM PROGRAM!! Agriculture is a most essential "public utility" and its health must be regarded as vital to society. Farmer's capital is invested locally - not S&L's or South Africa - giving a local return of 6 to 1, creating many local jobs.

Forms of this resolution passed, or in process by American and State Farm Bureaus, Corn Grower's Associations, Soybean Growers, Independent Bankers Association, Independent Businessman's Association, National & Regional Associated Milk Producers, NFO, NFU and many many other farm organizations. GET IT ON YOUR AGENDA!!

OBJECT - TREAT THE FARM INVESTMENT AS A 403 SPECIAL HYBRED ACCOUNT AND GRANT TAX DEFERRAL ROLLOVER TREATMENT AND PRIVILEGES TO THE SALE OF FARM ASSETS SUCH AS GRANTED TO IRA'S, 401K'S, KEOUGH, ETC. $10,000 F-RA PER YEAR OF FARMING FOR EACH FARMER AND SPOUSE, ELIGIBLE ONLY TO THOSE WHO PASS 5 YEARS OF "HANDS ON MANAGEMENT."

Wash. D.C. Phones - Sen. & Congress. 1-202-224-3121 CALL DAILY! DEMAND YOUR REP. SIGNS ON!
($.13/min call before 8:00 a.m.) Adm. 1-202-456-1414

KEEP

CONGRESSMEN SIGNED ON

WI 8 of 9 *1

State	Signed		
AL	0	OF	7
AK	0	OF	1
AZ	0	OF	5
AR	0	OF	4
CA	1	OF	45
CO	0	OF	6
CT	0	OF	6
DE	1	OF	1
FL	0	OF	19
GA	2	OF	10
HI	0	[illegible]	[illegible]
ID	0	[illegible]	[illegible]
IL	1	[illegible]	22
IN	1	OF	10
IA *	3	OF	6
KS	0	OF	5
KY	1	OF	7
LA	0	OF	8
ME	0	OF	2
MD	0	OF	8
MA	0	OF	11
MI	4	OF	18
MN	2	OF	8
MS	0	OF	5
MO	1	OF	9
MT *	1	OF	2
NE	0	OF	3
NV	0	OF	2
NH	0	OF	2
NJ	1	OF	14
NM	0	OF	3
NY	4	OF	34
NC	1	OF	11
ND *	1	OF	1
OH	3	OF	21
OK	1	OF	6
OR	0	OF	5
PA	2	OF	23
RI	0	OF	2
SC	0	OF	6
SD *	1	OF	1
TN	0	OF	9
TX	3	OF	27
UT	1	OF	3
VT	0	OF	1
VA	0	OF	10
WA	0	OF	8
WV	0	OF	4
WY	0	OF	1

SCORE

SENATORS SIGNED ON

*1 WI 2

AL, AK, AZ, AR, CA, CO, CT, DE, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA, MI, MN, MS *, MO, MT *, NE, NV, NH, NJ, NM, NY, NC, ND, OH, OK, OR, PA, RI, SC, SD, TN, TX, UT, VT, VA, WA, WV, WY

SENATE COMMITTEE ON FINANCE

Lloyd Bentsen, TX., (Chrm.): Daniel P. Moynihan, NY., Max Baucus, MT., David L. Boren, OK., Bill Bradley, N.J., George J. Mitchell, MA., David Pryor, AR., Donald W. Rigele, Jr., MI., John D. Rochefeller IV, W.VA., Thomas A. Daschle, S.D., John B. Breaux, LA., Bob Packwood, OR., Bob Dole, KS., William V. Roth, Jr., DE., John C. Danforth, MO., John H. Chafee, R.I., Dave Durenberger. MN., Steve Symms, ID., Charles E. Grassley, IA., Orrin G. Hatch, OR. (General address for U.S. Senate is: Name, Senate Office Building, Washington, D.C. 20510)

*1 - WI is also drafting state legislation

**Presently one spouse almost needs to die so the other can retire comfortably, benefiting by new cost basis established by the death - SAD!

The farmer has been a lifelong direct payer of excessive real estate tax bills, Social Security and income taxes and an indirect taxpayer through the hundreds of thousands of dollars of equipment and supplies purchased. HE HAS PAID FOR THE RIGHT TO AN ACCESSIBLE FARMERS RETIREMENT ACCOUNT.

The bills introduced; S 1130, HR 2333 and HR 2470 qualify farm assets for treatment as a self-directed IRA per se :

I. Full time farmer for a minimum of 5 years. (1) Farmer and farm spouse each accumulate eligibility at the rate of $10,000 per farming year. (2) Limit of $500,000 per farm. (3) If other IRA accounts exist that amount in excess of $100,000 is subtracted $1.00 for $1.00 from the $500,000 limit (F-RA + IRA combined limit = $600,000.)

II. Funds source - the net proceeds from the sale of qualified farm assets i.e. (1) farm real estate, (2) ALL capital and non-capital farm assets.

III. Funding period - The farm operation, income and expenses change greatly from year to year (spousal death, loss of health, child leaving home, temporary or permanent injury, loss of land, market, emergency sales, expenses, etc.) Therefore, the allowed F-RA may be funded as "qualified" finances are available.

IV. Withdrawal - Standard IRA rules apply.

The typical annual retirement package available to $12/hr. to $14/hr. employees is: (1) $3,000/yr. employer paid retirement; (2) $2,300 employer paid S.S. (7.65% vs 15.3%); (3) $7,500 shared or self paid 401K (with a $22,500 hardship make up privilege); (4) $2,000 self-paid IRA; TOTAL $14,800. (5) +Employer paid health insurance (6) + equal spouse's IRA account.

The $10,000 Farm IRA Bills are $4,800 less annually and provides less benefits than standard packages which additionally allow tax deferral on earned dividend income.

The day to day financial needs of the farm leave little to set aside for retirement. F-RA won't happen without your help!!!

HOUSE COMMITTEE ON WAYS & MEANS - Chairman - Dan Rostenkowski - IL. Sam Gibbons, FL., J. J. Pickle, TX., Charles B. Rangel, NY., Fortney Pete Stark, CA., Andrew Jacobs, Jr., IN., Harold E. Ford, TN., Ed Jenkins, GA., Thomas J. Downey, NY., Frank J. Guarini, NJ., Marty Russo, IL., Donald J. Pease, OH., Robert T. Matsui, CA., Beryl Anthony, Jr., AR., Byron L. Dorgan, ND., Barbara B. Kennelly, CT., Brian J. Donnelly, MA., William J. Coyne, PA., Michael A. Andrews, TX., Sander M. Levin, MI., Jim Moody, WI., Benjamin L. Cardin, MD., Jim McDermott, WA., Bill Archer, TX., Guy Vander Jagt, MI., Philip M. Crane, IL., Richard T. Schulze, PA., Willis D. Gradison, Jr., OH., William M. Thomas, CA., Raymond J. McGrath, NY., Rod Chandler, WA., E. Clay Shaw, Jr., FL., Don Sundquist, TN., Nancy L. Johnson, CT., Jim Bunning, KY., Fred Grandy, IA. (General address for Representatives is: Name, House Office Building, Washington, D.C. 20515)
PRIORITY ORDER FOR MAILING YOUR PETITION COPIES - (1) Your state's representatives on House and Senate Committees, (2) Where none exists, send petition to each of the committee chairman, (3) copy your Washington Senator, Congressman,(4)Governor

SIDE BENEFITS - Smooths farm transition from "Father" to "Son" - Provides needed accessible capital to rural communities when "roll-overs" occur - Eases or eliminates necessity of special tax averaging efforts by prolonged sales - Gets Dad out of the kids way sooner - Greatly reduces lawyer fees and need of involvements, etc.

PERSONAL NOTE:
Wisconsin's Racine/Kenosha County's Farm Bureaus, along with my wife, friends and neighbors, has provided leadership, support and encouragement to accomplish F-RA. For the past six years, I have traveled many thousands of miles (coast to coast, farm shows, three trips to D.C. - one trip was invited by Congressman Moody and provided with the use of his office and D.C. home - personal funds were exhausted) so we could promote this needed legislation. Senator Kasten and Congressman Sensenbrenner also provided much needed support as well as many other congressmen and senators.
I desperately need statewide and countrywide assistance. Two to four days assistance of a dozen good country boys may be all that is needed to pass F-RA. Call me! Maybe involve your presence in Washington - OPEN INVITATION!
Aggressive American and State Farm Bureau's participation is needed along with that of all Farm Organizations. JUMP START THEM WITH A KICK IN THE BUTT OR F-RA WILL NOT HAPPEN. Write Kleckner - Maybe he will answer you, he didn't me.

WISCONSIN'S RACINE COUNTY FARM BUREAU CHALLENGE
SENATOR KASTEN'S BILL S 1130 AND TWO BI-PARTISAN HOUSE BILLS - CONGRESSMEN MOODY HR 2333 AND SENSENBRENNER HR 2470, ALL WERE INTRODUCED AT MY URGING. BOTH WISCONSIN SENATORS AND 8 OF 9 WISCONSIN CONGRESSMEN SIGNED ON AS SPONSOR/CO-SPONSORS (ONLY KLECZKA HAS YET TO COMMIT). WE ARE ASSISTING OUR STATE (WI) LEGISLATION IN DRAFTING SIMILAR STATE LEGISLATION. IF I CAN DO IT, YOU CAN DO IT IN YOUR STATE - I'LL HELP - CALL. WITHOUT YOUR INVOLVEMENT "F-RA" WILL NOT HAPPEN!

Jim

James H. Harris, National & State Affairs Committee, Racine County Farm Bureau

PREPARED STATEMENT OF FERD HOEFNER

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to testify before you today on capital gains exemptions and other tax provisions affecting beginning farmers and farm debt relief. We appreciate your leadership in calling this hearing to consider these important matters.

Although the Center for Rural Affairs has historically taken a dim view of using federal income tax incentives to stimulate investment in agriculture, we see a role for very carefully crafted tax relief measures to enhance entry opportunities for beginning farmers and to remove tax obstacles to farm debt relief. We stress, however, that those measures must be carefully targeted if they are to avoid the adverse impacts on farm profitability and the family farm system of agriculture that have resulted in the past from creating tax sheltering opportunities and tax incentives for over-investment in agriculture.

The capital gains exemption is a perfect example of the proposition coined by University of Missouri agricultural economist, Harold Breimyer, that tax breaks that serve the short-term individual interests of family farmers often lead to their collective demise. We reach that conclusion because of the capital gains exemption's profound effects on the prices of farmland and farm products and on the competitive position of moderate-sized farms relative to large farms and nonfarmer investors.

The capital gains exemption turns breeding and dairy stock into tax shelters, enticing higher income taxpayers to establish or expand herds. The effect of reinstating the break, according to Neil Harl, Iowa State University economist and one of the nation's foremost experts on agricultural law and economics, would be an expansion of livestock herds, leading to greater livestock supplies and lower prices. It is also clear that moderate-sized, moderate income family farmers would be disadvantaged relative to larger and higher income farmers and investors, who benefit more from the tax break. For example, our analysis indicates enactment of the capital gains exemption passed by the House of Representatives in 1989 would provide tax benefits equal to a $3.28 per cwt. increase in the price of feeder cattle to a top bracket owner of a beef cow herd, but only 88 cents per cwt. to a family farmer or rancher in the 15 percent bracket. The top bracket owner of a farrow to finish hog operation would gain the equivalent of a 62 cents per cwt. price increase for slaughter hogs, versus 17 cents for the 15 percent bracket farmer. The top bracket owner of a dairy operation would gain the equivalent of a 25 cents per cwt. milk price increase, versus 7 cents for a 15 percent bracket farmer. Moderate-sized, moderate income family farmers would not gain sufficient tax savings to make up for the lower prices they receive for the meat and milk they produce. Tax favored large operations would be granted a competitive advantage with which to squeeze small operations out of business.

Likewise, reinstatement of the capital gains exemption would put moderate-sized, moderate income farmers at a disadvantage in competing for farm and ranchland and contribute to instability in the land market. The capital gains exemption turns appreciating land into an attractive tax shelter, especially for top bracket taxpayers. Under the old tax code, the capital gains exemption enabled a top bracket taxpayer to bid nearly $3,200 per acre for land appreciating eight percent per year, for which a 16 percent bracket taxpayer could justify only a $2,200 bid. (See The Effects of Tax Policy on American Agriculture, USDA, 1980.) Simply put, the capital gains exemption encourages top bracket tax motivated buyers to bid the price of land beyond that which can be earned by farming it. The flip side is that when land prices stop appreciating, the capital gains exemption is no longer of value and tax motivated buyers leave the market contributing to land price declines. The capital gains exemption makes the land market more volatile and helps high-bracket, large operators squeeze small farmers out of the land market.

In short, the capital gains exemption is bad for family farming. However, some forms of very carefully targeted capital gains relief could avoid these pitfalls while assisting new farmers in establishing a land base and enabling existing farmers to discharge excessive debt.

THE ROLE OF TAX POLICY IN CREATING NEW FARM OPPORTUNITIES

American agriculture is in need of a new generation of family farmers and new sources of affordable and accessible capital for those farmers. Nearly half of the nation's farm assets are controlled by farmers likely to retire in the next ten years, according to the Economic Research Service. Absent a new generation of family farmers, those assets and the opportunities they represent will simply concentrate into the hands of large and well establish operations, resulting in a permanent loss of rural people and opportunity. But farm entry rates have fallen severely. Between 1982 and 1987, according to the U.S. Census, the number of farmers under the age

of 25 fell by 43 percent, to less than 1 percent of the total, while the number of farmers between the ages of 25 and 34 fell by 17 percent. In fact, the ERS has reported that the decline in the number of U.S. farmers between 1982 and 1987 was due primarily to the decline in the number of people entering agriculture rather than the number of farmers leaving.

This decline is reflected in farmland sales patterns. In Iowa, 95 percent of 1990 land sales were to existing farmers or nonfarmer investors, while beginning farmers accounted for only 2 percent of land purchases. This in part, reflects the fact that the Farmers Home Administration (FmHA), traditionally a major capital source for beginning farmers, has, because of the farm debt crisis been forced to concentrate on financing for existing farmers.

If sufficient capital is to be available for a new generation of farmers, FmHA must be restored to its historic mission, as proposed by Rep. Tim Penny in H.R. 2401 and Sen. Charles Grassley in S. 1835. However, it is also vital that new sources of first farmer capital be made available to supplement and work in conjunction with FmHA.

FIRST TIME FARMER BONDS

One new and important though currently small, source of credit for beginning farmers is "first time farmer bonds." They provide beginning farmer financing at lower than commercial interest through their tax exempt status. However, the market for these bonds and their potential to serve beginning farmers has been severely constricted by an Office of Management and Budget (OMB) directive prohibiting federal agencies from guaranteeing loans made with the proceeds of tax exempt bonds. Given the fact that first time farmer financing is seldom risk free, this policy has effectively limited sales of these bonds to innovative arrangements whereby a bank identifies a qualified borrower, purchases a bond from a state beginning farmer program in the amount of the loan and contracts with the state program to service the loan—enabling the bank a degree of control over the risk associated with the bond. Subsequent to this innovation, however, the involvement of commercial banks was reduced by tax reform provisions restricting deduction of interest paid on deposits by banks that purchase tax exempt bonds.

We urge Congress to take several steps to maintain and enhance the effectiveness of first time farmer bonds as a source of credit for beginning farmers. First, Congress must extend the tax exemption on first time farmer bonds, scheduled to expire in July of this year, preferably on a permanent basis as proposed by Senate Bill 710. Second, we urge Congress to override OMB and allow FmHA to guarantee loans made with the proceeds of first time farmer bonds. This would expand the market for first time farmer bonds and increase the availability of this lower cost source of credit to beginning farmers. Finally, though it is beyond the jurisdiction of this Committee, we urge Congress to explore legislation to allow for creation and regulation of non-profit rural development corporations that could service FmHA guaranteed loans, including those made with the proceeds of first time farmer bonds. Such entities would constitute an aggressive new force in marketing first time farmer bonds to community-minded investors, and increase the number of beginning farmers who have access to this more affordable source of credit. A model can be found in California's "Small Business Corporation Law," under which nonprofit corporations are now making FmHA guaranteed loans to beginning farmers.

CAPITAL GAINS RELIEF FOR RETIRING FARMERS WHO SELL LAND TO BEGINNING FARMERS

Proposals now before the Senate to provide relief from capital gains taxation to retiring farmers who sell land could, with revision, simultaneously open opportunity to beginning farmers. Senate Bill 1130, under certain circumstances, excludes gains from sale of farmland from taxation if they are reinvested in an Individual Retirement Account. Likewise Senate Bill 2202, in certain circumstances, provides a tax exclusion on such gains reinvested in a principal residence. We fear that as introduced, these bills may simply facilitate the ongoing concentration of farmland, by putting more of it on the market to be purchased by large farmers and investors who have a strong base of existing assets and superior access to capital with which to buy the land. In many instances, this may cause beginning farmers to lose access to rental land with little corresponding increase in opportunities to buy land. (It should be noted that the competitive advantage that established large farmers and investors enjoy over beginning farmers stems not from greater efficiency, but from the ability to acquire the capital and income streams from existing wealth and other sources needed to overcome the short-term losses generally involved in buying farmland.)

However, were capital gains relief targeted to landowners selling to qualified first time farmers, such legislation would have the dual benefit of providing retiring farmers the opportunity to avail themselves of tax relief and providing beginning farmers a countervailing competitive edge in the land, With such targeted capital gains relief, the soon-to-be-retiring farmers controlling 50 percent of the nation's farm assets would seek out beginning farmers as buyers and would be willing to accept a lower price from them, in recognition of the tax benefits. It should also be noted that such targeting provisions would substantially lower the cost to the federal government of providing capital gains relief to retiring farmers.

Appropriate targeting mechanisms already exist in current law and proposed legislation and could be attached to these bills. We would propose using the first time farmer definition in the statute authorizing first time farmer bonds, or preferably, the beginning farmer definition found in the Beginning Farmer and Rancher Credit Act (H.R. 2401 and S. 1835).

BEGINNING FARMER ACCESS TO INDIVIDUAL RETIREMENT ACCOUNTS (IRAS)

In recent years, the Senate Finance Committee has discussed proposals to allow penalty-free withdrawals from IRAs for home purchase and costs of college level education. We urge that future discussions of those proposals also include allowing first time farmers to make such withdrawals to purchase land and other farm assets. That opportunity should also be targeted by the measures discussed in the preceding paragraph.

Whereas U.S. policy to date has focused on subsidized borrowing to assist beginning farmers, such a proposal would subsidize saving for the purposes of getting started in farming and making an initial land purchase. While we do not propose this as a substitute for credit assistance, it would provide a "risk averse" supplement to credit assistance that does not involve assumption of large debts that are sometimes difficult to repay. In concept, there is precedent for such an approach in a New Zealand program that matches savings placed in accounts by beginning farmers to be used for land purchase. Such a proposal would also address that bias against self employment in current IRA policy. Today, we subsidize retirement savings if they are placed in accounts to be lent to others, but we deny such subsidies for people who save to invest in businesses they own and operate and that constitute their own retirement savings.

THE TAX ON FARM FAILURE

Tax law does not distinguish between foreclosure, forced sale or voluntary conveyance of assets to a creditor and other transfers of property. The farmer must count as income the difference between the farmer's tax basis (usually the purchase price or zero if produced on the farm) and the asset's fair market value or sale price at the time of the transfer. This is so even if all of the sale proceeds or the property itself is turned over to the lender.

This is a particular problem for older, low income farmers forced to liquidate farm assets. If the farm was purchased in the 1950s, for instance, it's "basis" or purchase price is likely to be significantly lower than its value today. The resulting "gain" from a foreclosure or voluntary liquidation will be taxable and the farmer saddled with a significant tax liability. In instances where the farmer is left with little or no cash or wealth after the transfer, a large tax liability places additional stress on an already uncertain financial future. It denies these farm families a fresh start.

An after liquidation tax bill can slow down or prevent altogether the financial recovery of low and moderate income farm families. It can interfere with the family's ability to repurchase its home or make rental payments. In other instances, the tax consequences of scaling down a farm operation and discharging debt may interfere with a farmer's ability to restructure his or her debt. If farm families and rural communities are to recover from the farm credit crisis the tax impediments to debt restructuring must be removed.

A carefully crafted exclusion of gain upon the transfer of assets to satisfy debt would provide farm families a fair chance at a fresh start. The Farm Debt Tax Reform Act (S. 900) introduced by Senator Kent Conrad would allow farm families who meet certain income, equity and material participation requirements to exclude no more than $350,000 in capital gain or discharge of indebtedness income. The capital gain income would first have to be applied against tax attributes.

We urge the committee to support this measure. It does a good job of targeting its relief to those without the capacity to pay. Like the Agricultural Credit Act of 1987, it balances public costs and budget constraints with the public policy goal of responding to farmers in economic crisis. Its relief is well targeted to low-income

and limited-equity farmers. Its goal is simply to put farm families in a position from which they can rebuild their lives and livelihoods.

CONCLUSION

While reinstating the capital gains exemption would reduce farm profitability and undermine the family farm system of agriculture, more targeted measures have the potential to enhance first time farmer opportunities and remove tax obstacles to family farm debt discharge. We hope to work with you in crafting such measures. Thank you for the opportunity to present our views.

PREPARED STATEMENT OF SENATOR JAMES M. JEFFORDS

S. 887, WETLANDS AND GREENSPACE PRESERVATION ASSISTANCE ACT

Thank You, Mr. Chairman, for holding a hearing on S. 887, the Wetlands and Greenspace Preservation Assistance Act. I would also like to thank the Committee for your indulgence in letting me testify at this time. I had a previous commitment that I was unable to rearrange.

Land use, Mr. Chairman, I believe is one of the fundamental questions we have not yet adequately addressed either in this body or in society. Land use is at the heart of the wetlands controversy, is a major part of the endangered species dilemma, contributes to the landfill siting problem, and significantly impacts the activities allowed on federal and other public lands. Deforestation, for example, is another land use problem. One nation's use of their land can affect not only their citizens, but also the world as a whole. Closer to home, one of the main controversies surrounding the HydroQuebec James Bay project is the effect of flooding thousands of square miles of land.

As our population and that of the world grows land use pressures will intensify. In less populated times, Man's activities on land had little impact as their were not enough people for these activities to have global impact. But, as population grew, Man's activity began to change both the local and global environment. For example, the Sahara was once forested as were the hills of Bangladesh. Efforts to reforest populated areas, even if the climate cooperated, are not likely to be successful as without some form of protection, the populace would continue to denude the area. An example of this can be found in the most recent issue of National Geographic where India's struggle with land use is highlighted.

Similar analogies can be found in our country. Two hundred years ago, American's destruction of wetlands had little large scale impact as many wetlands remained. Now, however, there are comparatively few wetlands left, and many of these are threatened by our desire to develop new land. For our own sakes, we must begin to protect sensitive environmental lands. And, unless we find an effective, politically-acceptable means of doing this, the conflict between property rights and the environment will only grow.

I certainly do not have all the answers as to how to resolve this growing conflict. I do believe private property owners are entitled to certain rights, and that we should not infringe on these rights unnecessarily or without compensating the owner for the public benefit that results from environmental protection. The continuing controversy over wetlands is evidence that we have not yet figured out how to resolve these conflicting goals.

One thing I am certain of is that our government sends conflicting signals about environmental protection. For example, today the Environment and Public Works Committee began marking-up a bill to reauthorize the Resource Conservation and Recovery Act. One of the most controversial issues is recycling. To reduce the need for landfills, which cities often cannot site, cities are undertaking recycling programs. Unfortunately, in many cases, it costs more to use recycled materials than virgin materials. Thus, the current proposal would require industries to recycle and reuse a portion of their products' packaging. One reason virgin materials are cheaper for industries to use is that the federal government subsidizes the use of virgin materials. Thus, on one hand, we are telling industry not to use virgin materials, while on the other hand, we are subsidizing virgin materials to encourage their use. The American taxpayer and consumer end up paying twice, once for each conflicting goal.

Conflicting signals are also sent in terms of land preservation. The government has regulations to discourage the development of wetlands areas. Yet, when calculating taxes on these same lands the government requires that the land be assessed at its "highest and best use." To our government, "highest and best use" means developed. The effect of our government's definition of "highest and best use"

is to basically encourage land owners to develop the land or to sell land to developers to pay the taxes. To me, the highest and best use of land is in its natural undeveloped form, not as a condominium development.

The federal government is not the only level of government that sends this mixed message. Local governments often calculate property taxes in the same manner. This is most obvious when land is proposed for inclusion in national parks. Local governments express significant concern over the loss of this land from their tax rolls. Money is more important than green space or wetlands.

I do not propose to change local property taxes, but we can change the federal tax code. The approach contained in this legislation is the same as that currently used to protect family farms from the tax assessor. The inheritance tax code allows family farms to be assessed at their current use, and not the highest and best use, provided the family continues to farm the land for at least 10 years. I propose the same approach for other undeveloped land. I thank the Chairman and several of our colleagues for their support of this approach.

Briefly, before closing, I would like to comment on some concerns that have been raised to me about this bill. Some might argue that the inheritance tax code already allows a large exclusion from estate taxes. My colleagues know, however, that it often does not take much land to exceed this exclusion. That is why we've acted to protect family farms. Secondly, some might argue that this provision protects only the rich. Well, Mr. Chairman, the rich have very expensive estate tax attorneys to protect their interests. Those for whom most of their assets are their land often to not have the benefit of such legal counsel. Last, Mr. Chairman, some might say that this bill is nothing more than a tax shield that some can use to keep more of their land to develop later. These individuals would say that more than a 10 year easement is needed. I do not know the magic number of years, however, I am concerned that we not make the preservation easement neither too long nor too short. If the easement period is too long, we could discourage people from availing themselves of this opportunity to at least slow the speed of development.

Last, Mr. Chairman, this bill will add a provision that does not exist in the tax code. It will allow the beneficiaries an opportunity to preserve their lands. Currently, the decedent must arrange for some type of preservation in order for the beneficiaries to preserve any lands they inherit. The decedent, however, may have different values than the beneficiaries. This bill would allow the beneficiaries to choose preserve our precious natural resources.

Thank you again, Mr. Chairman for holding a hearing on this bill. I also thank you for your support.

Prepared Statement of Senator Nancy Kassebaum

Mr. Chairman, I am here to express my strong support for legislation to address the cash lease problem of Section 2032A. I cannot state strongly enough that, if we do not pass legislation to correct this problem in the near future, many hard-working families are literally going to lose their farms over what can only be characterized as a tax technicality.

As many of you know, Section 2032A was enacted several years ago to allow a special estate valuation for farms held and operated by a decedent's family for ten years after his or her death. In recent years, the Internal Revenue Service has begun auditing estates which made the Section 2032A election. The IRS's position is that cash lease arrangements between family members other than the decedent's spouse are not in compliance with the Section 2032A holding requirements.

This noncompliance determination is significant. Noncompliance makes the estate subject to retroactive taxes and penalties based on the farm's fair market value at the date of the decedent's death. Many Kansas farm families made the Section 2032A special-use election and subsequently engaged in intra-family cash lease arrangements. Needless to say, this is a big issue for those estates which have been audited. Many estates are now being assessed for amounts exceeding the farm's current value.

Two Senate bills have been introduced to address this situation. These bills are Senate bill 1045 and Senate bill 1061. The bills permit intra-family cash lease arrangements under Section 2032A on a retroactive basis.

At least one IRS district office is aware of the legislation and suspended proceedings against the farm estates for six months pending congressional consideration. The six months has expired. In light of the lack of progress having been made on the bill, the IRS is now preparing to proceed against the farms. In short, people are facing financial ruin and the loss of their farms if we delay further.

The congressional intent to keep these farms in the family, as understood by common family land-sharing practices, is absolutely clear. Cash lease agreements with extended family members are commonly accepted arrangements in the farm belt and should not result in IRS foreclosure proceedings against unsuspecting farmers who thought they were complying with the special-use requirements of Section 2032A.

PREPARED STATEMENT OF SENATOR ROBERT W. KASTEN, JR.

Mr. Chairman, thank you for this opportunity to testify before your subcommittee on the important topic of retirement security for America's farmers. I am pleased to note that later in this hearing you will hear testimony from Wisconsin farmer Jim Harris, the architect of this proposal, he will be representing the Racine County Farm Bureau. Jim has worked tirelessly to build support for the Farmers Retirement Account and I am pleased he is able to testify. I also wish to note that Senators Shelby, Burns, Kohl, Cochran and Coats join me as cosponsors of the Farmers Retirement Account.

In recent months I have held Small Business Committee field hearings throughout Wisconsin. In Racine, in Eau Claire, in Superior, in Green Bay, in West Bend, and in Waukesha. At each of these hearings witnesses from small businesses, community organizations, and farmers voiced their concern for America's future. They spoke of excessive taxation, massive federal deficits, the burdens of government red tape, the high cost of health insurance, and frustration with a federal government that has lost touch with hard-working Americans.

One of the principal topics discussed was the tremendous struggles faced by small- and medium-sized family farms. Today, a dairy farmer in Wisconsin who works a lifetime on the farm and then sells part, or all of that farm in the hope of a comfortable retirement, faces an immediate 28 percent federal capital gains tax, on top of state taxes. There is no consideration given to the fact that much of the farmer's so-called profit is due solely to inflation, or that farmers do not have access to company or government pension and retirement plans. Even their Social Security benefits are often lower than other workers because they pay themselves low wages in order to plow much of their gains back into the farm each year.

Farmers work hard their entire lives, they feed America's families and a good portion of the world, and the gift they get at retirement is a confiscatory tax of one-third of the value of their farms.

As Chester and Delores Davis, lifetime Wisconsin farmers, put it "while farming and raising a family we had to reinvest any income in machinery or upkeep and could not buy tax deferred IRAs. Now they are taking so much of our retirement investment for taxes that it leaves little to retire on. Is this fair?"

And Dan Poulson, President of the Wisconsin Farm Bureau observes: "as farmers, we build a great deal of personal property and other investment into our operations, the investments accrue over a long period of time. We face exceptional investment risks and the uncertainty of weather problems. Yet, when it comes time to retire we're faced with a lump-sum tax on the product of our lifelong work and risk-taking."

I believe farmers deserve better. The Farmers Retirement Account is a straightforward and simple approach to help farmers build a better retirement for their families. The proposal does not create a new program, it simply builds on the existing Individual Retirement Account or IRA. This legislation provides that farmers who sell farm assets be permitted to defer taxation on those assets provided the profits are rolled over into an Individual Retirement Account. A similar provision is currently provided for millions of Americans who sell their personal residences each year. Capital gains taxes are deferred provided the sale proceeds are rolled over into a new residence within 2 years.

The Farmers Retirement Account merely defers taxation and permits the farmer and spouse to spread the eventual payment of taxes out over a number of years as funds are gradually withdrawn from the IRA to meet retirement expenses. As the Joint Committee on Taxation notes in its analysis of the bills being reviewed at this hearing: "The rollover of gain on qualified farm property would effectively create income averaging for the taxpayer." And in addition to the benefits for farmers, the economy is helped by the billions of dollars of additional savings invested in IRAs.

The government will not lose a substantial amount of revenue from the Farmer Retirement Account. Even the Joint Committee on Taxation has provided a 5 year revenue estimate for this proposal of only $837 million, or less than $200 per year.

The Farmer Retirement Account is supported by the American Farm Bureau Federation, the Wisconsin Farm Bureau, Communicating for Agriculture, and other

farm organizations. Last month I offered the Farmers Retirement Account as an amendment to the tax bill. Even though this is a relatively new proposal, we received 45 votes. It is my hope that as the Finance Committee reviews tax legislation it will consider including a farm asset rollover provision among proposals that expand on the existing IRA. This would help America's farmers and it would help the economy by increasing national savings. Thank you.

PREPARED STATEMENT OF BRAD W. MCNULTY

I. FIRST-TIME FARMER ASSISTANCE

We see very few "first-time farmers in our practice in Rapid City. The extensive capital requirements of land, equipment and livestock make it very difficult for newcomers to make a profit in the industry. Most of those who do start out have some type of backing by their parents who are usually currently in the agricultural industry

A review of the financial information for first time farmers reveals that interest expense is a major item in their overall yearly expenditures. Converbations with them reveals their frustrations with having to pay high interest rates.

The program allowing states and localities to issue tax exempt bonds, to assist first-time farmers with borrowing at a lower effective interest rate, is exactly what the first-time farmers are requesting. The program should be made permanent.

I am not aware of the State of South Dakota currently utilizing the program. Additional steps need to be taken to expand the utilization of the program to those states that are not currently using it, once the program has been made permanent. There are several bonding authorities in South Dakota which could issue the bonds. One authority currently issues taxable revenue bonds the proceeds of which are loaned to farmers who use their Conservation Reserve Program payments as a means for making payments on the loan.

In our practice we continually counsel our clients that they must not cash lease the farmland that is subject to special use valuation. In those instances where the heirs do not get along well, we try to develop crop share agreements that all parties can live with.

S. 1045 and S. 1061 both would allow the use of a net cash basis lease in limited circumstances. The availability of a cash lease would make it much easier for all parties involved The non-operator would be able to continue to meet the qualified use test and the operator would be able to manage the farm as he best determines. The intent of the original legislation of limiting the benefits to those directly involved with farming, would still be met as at least one qualified heir would be at risk for the results of the operation of the farm.

S. 1061 offers a broader definition of individuals that could utilize a cash lease. It uses the term "qualified heir" while S. 1045 limits the cash lease availability to a decedent's spouse or lineal descendent. The term qualified heir includes a decedent's spouse and lineal descendants but also includes a decedent's ancestors and the spouse of a lineal descendent. The broader definition would be more beneficial as it would permit transfer of land between a wider number of individuals.

Special use valuation has only estate tax applications. It provides an individual with an increased opportunity to transfer a farm operation to his heirs at death. It provides no benefits during lifetime as special use valuation can't be used in valuing transfers subject to gift tax. we have clients utilize family land limited partnerships as a means of currently transferring ownership of land from one generation to the next. The requirement that fair market value of the property be used in valuing the gift reduces the ability to transfer property. Having special use valuation available for gift tax purposes would help increase the amount of land that could be transferred to children and would help make the estate and gift tax structure more "unified."

II. TRANSFERRING THE FARM TO CHILDREN: ESTATE AND GIFT TAX ISSUES

One of the major obstacles in the transferring of farm land to a person's heirs is the large estate tax liability faced by a decedent's estate. A large estate tax liability can force an estate's executor to have to sell a portion of the farm land in order to meet the tax liability. In order to help minimize the amount of tax an estate is required to pay, Congress adopted Internal Revenue Code Section 2032A, for deaths after December 31, 1976, which allows a qualifying estate to elect to use "special use valuation" in determining the value of farm land to be reported on the estate tax return.

The requirements of 2032A are mechanical in nature with the intent to limit its benefits to those individuals who are directly involved with farming. Since its initial adoption, the Code Section has been modified several times in order to make it more workable. It appears that another modification is needed to make the benefits of 2032A available to additional taxpayers.

Each qualified heir who inherits farmland must meet the qualified use test (i. e. have an equity interest in the operation of the farmland). Failure to have qualified use results in additional estate tax with the tax based on the fair market value of the property rather than the special use value.

In many instances siblings inherit the farm property but only one actually operates the farm. Current rules require that the non-operating siblings must enter into crop share agreements with the operator in order to avoid liability for the additional recapture tax. The use of a cash lease has been held to not be an equity interest in an operation and the use of a cash lease results in the recapture tax.

I have seen instances where the siblings do not get along. Due to various factors, they just can't work together. In other cases, large distances separate the heirs of farmland. The use of crop share agreements does not work well in either of these instances. If the heirs can't work well together, proper management decisions can't be made. If large distances are involved, it is difficult for the heir who is not near the farm to have meaningful input in the farm's operation.

III. CAPITAL GAIN/DEBT RELIEF

The agricultural financial crisis that occurred in the 1980's resulted in numerous farmers entering into debt restructuring agreements with lending institutions. In many instances, land, equipment and/or livestock were transferred to the lending institution in exchange for a write down of debt.

In many instances, the amount of debt involved exceeded the fair market value of assets transferred which exceeded the tax basis of the assets. For instance, a farmer may have acquired land at $100 per acre, was able to borrow money in an amount equal to $350 per acre due to the land's increase in value, but the land is currently worth only $300 per acre.

The lending institution would often request that the farmer make a large principal reduction on the amount of the loan so that the outstanding balance would be in line with the current value of the land. Most farmers were unable to make the principal reduction on the loan which ultimately resulted in the farmer and the lending institution entering into some type of debt workout. A transfer of assets from the farmer to the lending institution was not uncommon.

This type of transaction is cast as a two part transaction for income tax reporting purposes. The difference between the debt and the fair market value of the property is discharge of indebtedness income. The difference between the fair market value of the property and its tax basis is gain on the sale of property.

Internal Revenue Code Section 108 normally permitted the farmer to exclude the discharge of indebtedness income from taxable income under one of its operating rules: the discharge occurred in a title 11 case, the farmer was insolvent at the time of the transfer or the indebtedness was qualified farm indebtedness.

The application of Section 108 took care of only a portion of the problem. The farmer was still required to report the gain from the deemed sale of the property transferred to the lending institution as taxable income. This resulted in the farmer having a tax liability at a time when he had little or no ability to pay.

In one instance we worked on, a farmer had outstanding debt of $711,900 and had cattle and land with a fair market value of $489,500 and a tax basis of $244,000. The lending institution agreed to take the land and cattle in exchange for discharging the debt. The transaction resulted in debt discharge income to the taxpayer of $222,400, which was excluded from income due to insolvency, but the gain from the deemed sale of the land and cattle of $245,500 was reported as taxable income.

The transaction did not result in an immediate tax liability to the taxpayer in the year of the transaction. However, having to report the gain as taxable income reduced the taxpayer's net operating loss carryforward which resulted in additional tax in following years. S. 900, as proposed, would have allowed the taxpayer (if the qualifications were met) to exclude the gain from income. This would have permitted the taxpayer to make an election under Internal Revenue Code Section 108(b)(5) to apply the required reduction in tax attributes to the basis of depreciable property thereby preserving the net operating loss.

While this taxpayer did not have a current year income tax problem, other taxpayers have not had net operating loss carryforwards to offset the recognition of taxable gain.

A taxpayer had a transaction involving debt of $250,000, land with a fair market value of $120,000 and a tax basis of $76,000. In this instance, the debt discharge income of $130,000 was excluded from income due to bankruptcy but the gain on the deemed sale of the land of $44,000 was reported as taxable income.

S. 900 provides legislation to help reduce the current tax impact to farmers who have entered into debt restructuring agreements. The legislation provides mechanical tests to determine which taxpayers can utilize the proposal. One is a modified adjusted gross income test based on 3 of the prior 5 years and the other is a gross receipts test based on 6 of the prior ten years. The legislation is also retroactive to years beginning after 12/31/86. I have a concern that the taxpayers who could utilize the proposal the most may not have the necessary documentation available to show that the meet the mechanical tests. In some cases, a taxpayer may need to have records as far back as 1977.

Section 2 of the bill contains two provisions for reducing the amount available for exclusion by other amounts excluded from income. The $300,000 allowable exclusion is reduced by any prior year amount excluded under either the provisions of this bill or under Internal Revenue Code Section 108(g), which deals with discharge of qualified farm indebtedness. If there is other debt discharge in the same year, any amount excluded from income under Section 108 reduces the allowable $300,000 exclusion.

These provisions can have different results depending on the ordering of discharge if a taxpayer is contemplating two debt restructuring with two different institutions. Assume the first restructuring is simply a debt write down and the second includes the transfer of assets as part of the restructuring. Also assume the taxpayer is insolvent. If both restructurings are done in the same year, the amount excluded from income from the debt write down reduces the $300,000 allowable exclusion. However, if the debt write down was done in one year, and the asset transfer was done in the following year, the debt write down would not reduce the allowable $300,000 exclusions as it is not a Section 108(g) transaction.

The provisions should be modified to achieve a consistent result.

Prepared Statement of Grace Ellen Rice

Mr. Chairman, I am Grace Ellen Rice, Associate Director of the Washington Office of the American Farm Bureau Federation. I am appearing today on behalf of the nearly 4 million families who are members of the American Farm Bureau Federation. Farm Bureau members produce every type of commodity grown on a commercial basis in the United States.

The tax decisions of the Senate Finance Committee affect our membership as much as the decisions of the agriculture committees, and we are pleased that the subcommittee is holding a hearing on several bills important to farmers and ranchers.

Farm Bureau policy is adopted by producer members of Farm Bureau at the county, state and national levels of the organization. There are several positions within our policy that speak to the bills before the subcommittee today.

At the 73rd annual meeting of the American Farm Bureau, our voting delegates adopted the following policy:

> "We urge Congress to permanently extend the authority for federal tax-exempt Private Activity Bonds (aggie bonds) which are used by states to finance loans to beginning farmers.
>
> "We support a capital gains exclusion for insolvent farmers on liquidation of farm property.
>
> "We support a capital gains exclusion for landowners who are forced to sell by condemnation and who do not wish to purchase new land to continue agricultural operations.
>
> "We support continuation of the once-in-a-lifetime exclusion of up to $125,000 in capital gains on the sale of a primary residence by a taxpayer over 55, and changes in law to allow portions of the resident farm other than the immediate farm residence to be eligible for the exclusion.
>
> "We support a provision to allow a farmer, other business owner or self-employed taxpayer, in contemplation of retirement, to invest proceeds from the sale of property and machinery in an IRA, Keogh plan or similar retirement account and pay taxes only at time of withdrawal."

In addition, Farm Bureau has the following policy on estate taxes:

> "We support repeal of federal estate taxes.

"We oppose any reduction in the current federal estate tax exemption. Until repeal becomes politically feasible, we support an increase in the exemption to ease the movement of farms from one generation to the next.

"We support elimination of the $750,000 ceiling allowed in determining the existing exemption under Internal Revenue Code 2032A for agricultural productive value."

Mr. Chairman, while we have not had an extensive amount of time to analyze the technical implications of the bills before the subcommittee, Farm Bureau policy directly addresses the concepts contained in S. 710 (first-time farmer bonds), S. 900 (capital gains tax relief on transfer of farm property to satisfy an indebtedness), S. 1130 (farmer individual retirement account) and S. 2202 (exclusion of gain on sale of farmland with an adjoining' principal residence). We support these bills.

While our policy does not directly address S. 887 (special valuation of sensitive environmental areas for estate tax purposes) and S. 1045 and S. 1061, which deal with leases to lineal descendants and qualified heirs for estate tax special use valuation purposes, our policy leads us to support all legislation that eliminates or eases the estate tax burdens on farmers and ranchers.

With this general position in mind, we are pleased to offer our support for the legislation being reviewed by the subcommittee today. We also encourage the subcommittee to affirm the importance of capital gains treatment to agriculture because of beneficial effects to owners of farmland, livestock and timber.

Also, the health insurance tax deduction for self-employed farmers and ranchers is important to agriculture. We appreciate the work that you and other members of the subcommittee have done on behalf of the deduction. We look forward to the day when the deduction will be made permanent and for the total amount of premium.

Farm Bureau appreciates the opportunity to appear before the subcommittee. Thank you.

PREPARED STATEMENT OF DAVID M. SAXOWSKY

Mr. Chairman and Committee Members, Good afternoon. I am David Saxowsky, an Associate Professor of Agricultural Economics at North Dakota State University in Fargo, North Dakota. Thank-you for the opportunity to comment on Senate Bill 900, the Farm Debt Tax Reform Act of 1991.

The nation has been hearing since the mid-1980s about the financial plight that thousands of U.S. farmers have experienced. Although the level of financial stress for some farmers has decreased, it has not disappeared from the industry. For various reasons, a portion of farm operators find their profit margins evaporating, leaving them unable to pay their financial obligations as well as provide an adequate level of family living. Likewise, there are many agriculture loans that have been delinquent but unresolved for several years. It is inevitable that in the next few years a substantial amount of agricultural debt that is either currently delinquent or that will become delinquent will have to be resolved through financial restructuring of the business or liquidation of assets.

To reduce their indebtedness, farm operators usually liquidate some of their assets either by selling the property and paying the proceeds to the lender, or by transferring ownership of the assets to the lender. In both cases, an unexpected obligation is a possible tax liability.

The tax obligation can be especially burdensome when two circumstances coincide. One, the farmer has no equity in the asset (usually land) because the amount of debt nearly equals or exceeds its value. Two, the tax basis of the land is less than its current market value. It is not uncommon for farmers to have little or no equity in land that has a low income tax basis. Most frequently, the situation arises for operators who bought land more than 15 to 20 years ago but used increases in its value as security for loans to pay operating costs, capital investments, or family living expenses. Now the farmer has no equity in the land yet faces an income tax obligation if the land is sold or transferred.

When both situations occur, all or nearly all the proceeds from a sale must be paid to the secured creditor or mortgage holder. This leaves the farmer with little or no cash remaining for payment of income tax. Yet there is a taxable gain on the transaction to the extent the value of the land exceeds its tax basis.

The situation is similar for farmers who transfer encumbered property to a lender in satisfaction of the debt; that is, there is no cash remaining from the liquidation of the property with which to pay any resulting income tax liability.

Taxable gain without any cash is a problem for farmers who are restructuring their business as well as for farmers who are discontinuing their farm business for

economic reasons. This latter group are individuals and families leaving agriculture after 15 or more years without equity but facing an outstanding tax liability. Past studies in our department revealed that one-third of North Dakota's former farmers had a negative net worth and nearly one-half reported an increased tax obligation due to liquidation. The concern about taxable gain due to sale of land or restructuring land debt is not as great for persons who initiated their farming career since the mid-1970s.

Although Chapter 7 bankruptcy may appear to be an alternative for exiting operators, it is unattractive due to the lingering uncertainty about the taxation of property abandoned by a bankruptcy trustee. Even though that issue is beyond the scope of Senate Bill 900, it is a consideration in that it demonstrates that there currently is no good alternative solution.

Income tax liability also is a problem for farmers hoping to continue their farm operation after financially restructuring it. Again, bankruptcy (including Chapter 12) does not reduce the farmer's tax liabilities. As a result, many farmers have delayed restructuring and retained ownership of some land longer than they desire and, in some cases, probably longer than they should. Their decisions to postpone financial reorganization have been based, in part, on their desire to delay triggering an income tax liability that they expect they will be unable to pay it. Similarly, numerous farm operators who have restructured their business find themselves unable to meet their continuing obligations plus pay the resulting tax liability.

One impact of Senate Bill 900 is that it would reduce federal revenue to the extent that taxes imposed under the current law would be paid. However, if these individuals do not have the resources to pay the taxes, this legislation would have minimal impact on federal tax revenue. If the taxes are not paid whether or not Senate Bill 900 is enacted, the major impact for the farmers will be the peace of mind that comes from eliminating an obligation that they know they can not pay.

A more significant impact may be that farmers will no longer delay restructuring or the sale of encumbered assets. The current law is not neutral to the extent that potential tax liabilities discourage farmers from resolving their indebtedness. An impact of Senate Bill 900 would be that farm borrowers may move more quickly to resolve their debts and thereby clarify the availability of land and capital resources for alternative uses and users.

My experiences in working with farmers and conversations with practitioners reinforce my understanding that the issue of taxable gain remains a problem for farmers who are restructuring their business. For example, in a conversation last week, a practitioner emphasized to me that some farmers are staying in agriculture longer than they wish because they cannot find a way to leave the industry without incurring an unacceptable tax liability. Clearly, income tax consequences have been and continue to be a concern for financially-distressed farmers.

The focus of this problem is not on the tax consequences of debt discharge nor the lack of equity due to accumulation of unpaid interest. The problem being addressed this afternoon arises when 1) the principal amount of the loan equals or exceeds the market value of the encumbered asset, and 2) they both far exceed the tax basis of the property.

Although the rate of financial restructuring in agriculture is somewhat less than it was several years earlier, reorganizations continue to occur. Furthermore, we expect that restructuring will continue into the future as producers in this competitive industry leave the sector for economic reasons. This problem that has impacted thousands of farm operators since 1986 will continue to be a concern into the future for low-equity mid-career farm operators.

Prepared Statement of Sarah Vogel

Good afternoon, Senator Daschle and members of the committee. For the record, I am Sarah Vogel, Agriculture Commissioner for the State of North Dakota. I appreciate the opportunity to testify before your committee this afternoon on the critically important issue of tax consequences of farmer insolvency.

As you are aware, Congress has taken many steps to deal with the painful effects of falling prices, rising costs and land devaluation, which hit U.S. agriculture in the early 1980's and which still continue today.

One of the steps taken by Congress was passage of the Agricultural Credit Act of 1987, which guarantees certain debt forbearance, deferral and settlement rights for Farmers Home Administration and Farm Credit Services borrowers.

Stated briefly, the Act provides that a farmer's debt may be restructured through the available options when it is cheaper for the government to restructure the debt than it would be for the government to foreclose that debt. And in reality, I believe

the government is better off recovering what debt the farmer can feasibly repay, while keeping the farmer on the land and a productive member of society.

The Act has not meant salvation for all FmHA and FCS borrowers, but it has helped many farmers remain on the land. At minimum, the farmer may be able to settle the debt(s) with FmHA and/or FCS, retain the homestead and start a new life in a different vocation.

It is unfortunate that the benefits of debt restructuring procedures often come to an end when the borrower is notified by the Internal Revenue Service of a large tax liability.

The tax is usually due to a large "gain" the farmer realizes when his debt is restructured or settled.

On paper, debt restructuring (including land sales or transfers) appears to generate income for the farmer debtor, but in reality this is not the case. The debtor seldom sees money from land sales for debt settlement; furthermore, land conveyed or deeded back to the creditor to satisfy debt does not result in actual "income" for the debtor, but instead a reduction of debt.

Unfortunately, current U.S. tax law does not distinguish the tax consequences of sales of land sold or transferred under economic distress from other transfers of property for profit.

Contrary to expectations, many of the farmers now facing high tax bills resulting from farm debt settlement are not those farmers who bought overvalued farmland the late 1970's and early 1980's. Although the latter group of farmers face severe economic distress, they generally do not have IRS problems because the sale or transfer of their property does not generate a gain.

Attachment A shows the precipitous rise and fall of land values since 1974.

The people most adversely affected by current U.S. tax law are older farmers who bought land prior to 1974 when land prices began to rise sharply.

This problem arises because the land belonging to these older farmers presently has a higher value than the purchase price or basis. Moreover, many of these farmers have been unable to fully repay operating loans due to low prices or disasters. Many of them refinanced delinquent operating loans by putting first or second mortgages against their land.

Let me provide you with an example of a farmer faced with this situation. The farmer cannot cash flow his or her operation and is forced to either liquidate, deed back or face foreclosure. Each of these events triggers a tax liability that the IRS treats as a sale.

Typically the farmer is in his or her late 50's, with either no or very low tax attributes to carry forward to offset the "gain."

The only feasible option the farmer has is to try to scrape by until retirement age of 62 so he or she can receive a monthly Social Security check, which is generally the lowest level. The Social Security check cannot be offset by the IRS.

At age 62, the farmer may move off the farm into subsidized low income housing, receive food stamps and fuel assistance.

This farmer will probably die with this tax liability left unpaid, but as an option after three years the farmer may decide to file a Chapter 7 to be free of the tax liability. What a demeaning and humiliating way of treating America's food providers.

The current tax laws also affect younger farmers in North Dakota who have bought little or no land, suffered disaster losses and used up all available depreciation. If forced to liquidate, our younger farmers also face a tax liability if debt is compromised or settled.

Both scenarios are a lose/lose situation for everyone involved, including the farmer, lending institution, federal government and the American taxpayers.

Let me provide a more specific example using fictitious people. Let's say a farm couple in their mid-50's bought a farm after they were married and paid $40,000 for it. Now, it's 1992 and the land is valued at $300,000. Over the years the couple has accumulated $300,000 worth of debt on the land, which gives them a debt to asset ratio of 1/1.

In the debt settlement process they deed back to FCS seventy-five percent of their land ($225,000) and keep twenty-five percent (valued at $75,000). Of the twenty-five percent which they keep, $30,000 represents the homestead, which they get free and clear as a result of the debt settlement agreement. This leaves them with $45,000 worth of debt against the remaining land.

The IRS looks at this situation and views the $225,00 deed back, minus the apportioned $30,000 purchase price, as a $195,000 capital gain for a tax liability of $54,600.

Instead of looking at what the farmer is left with ($30,000 in assets, $45,000 in debt), the IRS looks at what the creditor receives and views it as the farmer's gain.

The tax liability will be computed on $195,000, even though the couple is flat broke and still in serious debt.

It should be clear from this example, that the couple will be completely unable to pay the $54,600. Where would the money come from?

Since I was elected in 1988, I have been taking calls from farmers concerned about situations quite similar to those I've just illustrated. Recent conversations with farm and tax attorneys in North Dakota have disclosed that farmers are left with tax debts ranging from $6,000 (this person had no income) to up to $500,000 (resulting from debt settlement via deed back, conveyance and bankruptcy).

This tax is grossly unfair to agricultural producers and is virtually impossible to collect. The famous cliche, "You can't get blood from a turnip," applies to these situations.

Results from a 1989 study done at North Dakota State University on the effects of farm liquidations indicates that this problem was widespread in North Dakota. According to the study, potential tax liabilities were a substantial problem for many people trying to liquidate their farm operation. Approximately forty-two percent of the people who responded to NOSU's survey indicated that liquidation resulted in increased tax liabilities.

The average liability resulting from liquidation was $20,000. Furthermore, the study revealed that most families who liquidated or left their farming operations because of debt had very limited income. The median family income for the group was $18,000; twenty-nine percent of those responding to NDSU reported incomes of less than $10,000. For nearly one-third of the respondents, debt exceeded the value of their assets after liquidation. Finally, another seventeen percent reported a positive net worth of $10,000 or less.

In 1989, I testified before this committee on the urgent need for this legislation. The problem has not gone away. As Commissioner of Agriculture, I run a program called the Agricultural Mediation Service. We currently have over 800 farmer clients and expect a huge influx during the month of May because FmHA will soon be sending almost 1,600 restructure packets to North Dakota farmers.

In the Ag Mediation Service, we employ 33 negotiators and mediators, who work hand-in-hand with our farmers. They identify the IRS tax liability issue as the number one reason why we are sometimes unable to work out win-win solutions to financial distress. Many times arrangements by which the farmer may be able to keep a base in the community, and by which the lender is able to obtain a better net recovery than they would receive if they foreclosed, fall apart because of the IRS. Instead, the farmer may seek to put off the day of reckoning until he or she can qualify for social security, or try bankruptcy in an attempt to have the estate carry the liability.

Mr. Chairman and members of the committee, I also support Senate Bill 1061.

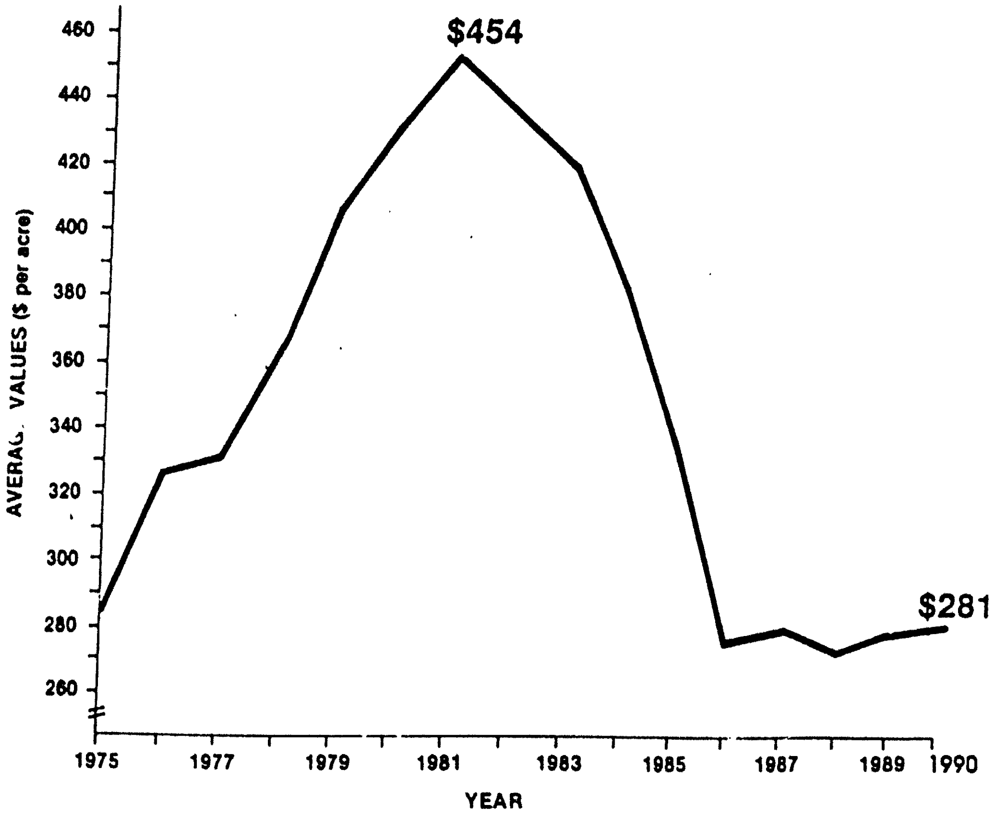
Currently, the law allows special use valuation of farm property to surviving spouses who continue to cash rent the farm property to their children. The need for the amendment arises when there is no surviving spouse and the land is transferred to the children or heirs who are currently not eligible for the special use valuation. This results in a higher tax that many farm families are unable to pay without selling the property.

The current oversight in the tax code makes it difficult for many farm families to keep an on-going farming operation in the family when the property owner dies. Special use valuation of farm property should be extended to all qualified heirs. For this reason the North Dakota Department of Agriculture supports Senate Bill 1061.

In closing, I would like to urge the Committee to work for quick passage of these important bills. Their timely passage is a matter of financial life and death to many people involved in American agriculture. I especially support the retroactive relief that the Senate Bill 900 would provide. Passage would alleviate the suffering of many hard working people who have suffered enough.

Thank you, Senator Daschle and members of the Committee, for your attention.

Attachment A



Change in estimated average value of North Dakota farm and ranch land, 1975-1990.

COMMUNICATIONS

STATEMENT OF THE AMERICAN PLANNING ASSOCIATION

The American Planning Association appreciates your invitation to present its views on S. 887, which would provide for special valuation of sensitive environmental areas for estate tax purposes in order to help preserve them in a natural and undeveloped state.

The American Planning Association (APA) is a national organization of over 27,500 members, including public and private planners and elected and appointed officials at all levels of government as well as educators, students and interested citizens. Our members belong to 45 chapters covering every state and Congressional district.

APA was formed in 1978 when the American Institute of Planners, established in 1917, and the American Society of Planning Officials, founded in 1934, were consolidated. The Association's primary objective is to advance the art and science of planning for the improved development of the nation and its communities, states and regions, as well as to preserve its valuable natural resources.

Historically, APA supports the protection of open spaces, natural areas, and scenic lands in well planned development. This statement is based on APA's formally adopted Environmental Quality and Wetlands policies. APA is concerned about the alarming rates at which critical nonrenewable and renewable natural resources are being degraded and permanently impaired by human activities. APA supports federal, state, and local actions to integrate improved environmental protection with balanced comprehensive plans and measures to implement these plans. APA supports financial and other incentives to encourage voluntary actions by landowners and others, consistent with the objectives of comprehensive plans.

APA commends Senator Jeffords's initiative in advancing this bill. Its protective goals are ones which are found being articulated with surprising strength in many places throughout the country, despite the recessionary environment, as citizens and officials alike seek innovative ways to preserve valuable open spaces at risk.

There are persuasive arguments for federal action to correct the problem addressed by this bill. At the same time, APA has serious concerns about the bill as now drafted, and wishes to suggest ways that the tax benefit could result in greater public benefit by providing a stronger impetus for comprehensive community planning that guides balanced open space protection and longer term voluntary arrangements to protect quality undeveloped lands.

APA commends the Jeffords bill for the following reasons:

1. It makes sense to modify the estate tax code consistent with the public's significantly increased support for measures to conserve valuable land resources. Recent years have seen, throughout our towns, cities, and rural communities, growing public concern about the disappearance and degradation of critical and valuable scenic, natural, and recreational resources. Citizens have backed a variety of federal, state, and local measures to slow the rate of loss—creative zoning; community, regional, and statewide plans; increased public dollars to buy land; donations of private dollars to private landsaving organizations like The Nature Conservancy, Trust for Public Land, the Conservation Fund, and hundreds of local and regional trusts; and incentives for protecting lands that remain in private ownership. The provision that is targeted for change by the Jeffords bill is, simply put, out of sync with today's sensibilities about the importance of protecting valuable undeveloped lands.

2. The bill's reliance on voluntary, nonregulatory incentives to "do the right thing" is commendable. The American Planning Association recognizes the importance of providing financial incentives and encouraging voluntary action to implement community land use goals. The proposed measure would reduce the effect

of coercive market forces that force heirs to sell environmentally sensitive lands that they wish to but cannot afford to keep undeveloped. In targeting the critical juncture at which heirs make a decision to retain or sell land, with the choice often one that involves yes or no to development, the provision would give heirs more choices and time to consider the future of their land.

3. **The proposal encourages experimentation with land protection methods in ways that put less burden on public management.** Despite wide citizen support for land protection and bonds, special taxes, and other dollars to buy land, there will never be enough public funds to purchase sensitive environmental lands for federal, state, or local ownership. Nor would this be a wise goal to shoot for. Consistent with protection objectives, continued private stewardship and productive use of lands are often desirable. The existence of a strong network of private land conservation groups, including regional and local land trusts, could provide, if needed, grass roots advice to help heirs understand their choices and, if they opt for protection, to act on this decision. Thus, the Jeffords bill could spur partnerships and leverage private action.

4. **Passage of a sound pro-open space provision in estate tax valuation will provide federal leadership for state and local measures to neutralize the adverse impact of estate taxes on voluntary decisions which affect the realization of community land use objectives.**

While supporting the thrust of S. 887, APA—which is committed to planning that involves all affected interests and balances land conservation with other significant public objectives (such as providing for needed development and raising revenues), offers the following suggestions for improvement. These are aimed at ensuring more public benefit in return for foregone revenue, guarding against abuse by speculators, and reducing the possibility that an offer of tax savings with fewer strings attached could threaten negotiations with landowners to conclude voluntary perpetual conservation easements.

1. **Fashion tighter provisions to provide longer term protection in landowner agreements.** In exchange for the benefits of special use valuation, the public should gain a longer time frame for land protection. The recapture provisions go some distance but not quite far enough, since an unintended effect could permit land to be banked by developers until it is ripe for development, and price escalation and profit potential make the penalty irrelevant. While there might be a legitimate planning objective to build in a mechanism for reviewing long term easements after a period of time has elapsed, there are other ways to accomplish this objective.

2. **Tighten the definition of the term "sensitive environmental resources" and clarify the mechanisms for making these decisions.** As planners, we would like to see definitions as well as financial incentives tightened so that foregone federal funds are expended for quality land resources identified in local, regional, and state plans when these plans exist, and to encourage communities to adopt such plans where these do not exist. These plans should guide needed development as well as land conservation. Linkage with use taxation policies at the community level, with state reimbursement of foregone property taxes, at least for some communities, would also seem desirable. Recognizing that effective planning, despite recent progress, still lags in many places in the country, a complementary strategy could require heirs to donate easements to qualified entities, including private nonprofit land conservation groups. This could provide some certification of the quality of the lands in question and encourage community dialogue in priority setting, linking of open spaces, and monitoring of the agreement. Such a measure would engage nonprofit land conservation groups in the process in ways in which they are proving to be increasingly effective.

APA has considerable interest in the objectives of this bill, and hopes that these suggestions will be helpful in strengthening its ability to use limited public resources efficiently to preserve open space and other critical natural resources. In preparing this testimony, we have not had the benefit of estimates of tax revenues lost and benefits gained, and we recommend that further elaborations of this proposed program develop these more fully, given the realities of the time. APA will be pleased to work with staff in developing any of these ideas more fully.

Thank you very much for this opportunity for the American Planning Association to present its views.

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