

SOIL AND WATER CONSERVATION TAX CREDITS

JOINT HEARING
BEFORE THE
SUBCOMMITTEE ON
ENERGY AND AGRICULTURAL TAXATION
AND
SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE
OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
NINETY-EIGHTH CONGRESS
SECOND SESSION
ON
S. 152 and S. 2180

MARCH 5, 1984

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SOIL AND WATER CONSERVATION TAX CREDITS

MONDAY, MARCH 5, 1984

U.S. SENATE, SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION AND THE SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE, COMMITTEE ON FINANCE

Washington, DC.

The subcommittees met, pursuant to notice, at 2 p.m., in room SD-215, Dirksen Senate Office Building, the Honorable Charles E. Grassley (chairman) presiding.

[The press release announcing the hearing, Senator Grassley's prepared statement, and a description of S. 152 and S. 2180 by the Joint Committee on Taxation, follow:]

[Press Release No. 84-120, Feb. 23, 1984]

FINANCE SUBCOMMITTEES ON ENERGY AND AGRICULTURAL TAXATION AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE SET HEARING ON SOIL AND WATER CONSERVATION TAX CREDITS

Senator Malcolm Wallop (R., Wyoming), Chairman of the Subcommittee on Energy and Agricultural Taxation of the Committee on Finance and Senator Charles E. Grassley (R., Iowa), Chairman of the Finance Subcommittee on Oversight of the Internal Revenue Service, announced today that the two Subcommittees will hold a joint hearing on S. 152, introduced by Senator Jepsen, and S. 2180, introduced by Senator Grassley for himself and others. These bills are intended to provide an investment tax credit for certain soil or water conservation expenditures.

The hearing will be held on Monday, March 5, 1984 at 2 p.m. in Room SD-215 of the Dirksen Senate Office Building.

OPENING STATEMENT OF SENATOR GRASSLEY

I am pleased to be a co-chairman of a hearing of great importance to farmers and conservationists throughout the United States. The two bills before us are S. 152, sponsored by Senator Roger Jepsen, and S. 2108, which I have sponsored with the co-sponsorship of my distinguished co-chair, Senator Wallop. Five other colleagues of mine on this Committee have joined the two of us in co-sponsoring this bill.

As evidenced by the efforts of Iowa's senators, soil conservation is a crucial issue to my state of Iowa, as well as the entire nation. The rate of soil erosion and the effect of soil loss on the future productive capability of our land are serious issues for everyone in agriculture. Some analysts have questioned whether the lack of federal and state attention to this growing problem will jeopardize our nation's efforts to meet future food needs, both domestically and worldwide. The increasing depletion of our soil is alarming because it shows a disregard for an important natural resource and indicates poor management of our nation's farmland.

In 1932, the Council for Agricultural Science and Technology (CAST) concluded that soil erosion was most severe in 12 north central states. In the Corn Belt, soil losses of 10 tons per acre were common on 10 percent of row cropped land; on some parcels, the soil loss exceeded 40 tons per acre annually. Unfortunately, soil loss is not limited to these 12 states. In the southeastern states, erosion rates of more than 11 tons per acre occurred on 32 percent of the land used for row crops. The highest

soil erosion rates in the nation are on the 26,000 square miles of the upper Mississippi Valley which includes the states of Tennessee, Kentucky, Mississippi, Louisiana, and Arkansas. Similar statistics show severe soil loss in the Mountain states and on the Columbia Plateau in the Pacific Northwest.

Farmers' dramatic increases in crop yields have masked the damaging effects of soil and water erosion. In the CAST report, one scientist noted that studies with corn have shown a yield reduction of 1 to 9 bushels per acre for each inch of topsoil loss. These losses are offset by use of fertilizer and improving pest control. Nevertheless, we cannot afford to gamble that the technology of the future will save us from our current inattention to this problem.

Economically, farmers have fallen upon very hard times. Many feel it is necessary to get the maximum production possible out of their soil merely to stay in business. Consequently, soil conservation efforts are suffering. In this climate, it is particularly appropriate that we provide greater incentives to farmers to assist them in preserving their soil.

Senator Jepsen is a recognized leader in the field of soil conservation. As a member of the Senate Committee on Agriculture, he chairs the Subcommittee on Soil and Water Conservation, Forestry and Environment. His bill would permit taxpayers to claim a 10 percent investment tax credit for improvements currently eligible for the expensing contained within Section 175.

My bill permits farmers to claim a 20% credit for installing certain approved soil and water conservation practices. The list was recommended by the Soil Conservation Service. To enable the credit to remain compatible with state-of-the-art advances, we have included regulatory authority to insert new technologies.

To address the criticisms of past soil conservation tax credit bills, we have narrowly defined eligible technologies and required the Soil Conservation Service to certify these improvements. Many of my urban colleagues have remarked that my previous effort would have permitted a taxpayer to receive a tax credit for a swimming pool as a pond or planting trees in the front yard as a windbreak.

In an attempt to limit this tax credit to farmers who are actually earning their living farming rather than create a subsidy for sodbusters, we have inserted certain restrictions. First, the total amount of soil conservation benefits cannot exceed 25% of an individual's gross income from farming; therefore, passive investors who do not earn their living farming would not be eligible for the credit. Also the bill requires certification by SCS to be sure the recipient of the credit has employed a proper soil conservation technology. Finally, to qualify for the water conservation portion of the credit, the eligible system must be a replacement rather than a new system to irrigate marginal land.

These limits are important because the credit is very generous. It provides a 20 percent credit for these improvements and straight line depreciation. In my opinion and the opinion of the 6 other Finance Committee Senators who have co-sponsored the bill, soil conservation efforts merit a 20 percent credit. The problem is so serious we need a major incentive to encourage farmers to preserve their land now and for generations to come.

**DESCRIPTION OF SOIL AND WATER
CONSERVATION TAX CREDIT BILLS
(S. 152 and S. 2180)**

SCHEDULED FOR A HEARING

BEFORE THE

**SUBCOMMITTEE ON ENERGY AND
AGRICULTURAL TAXATION**

AND THE

**SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE**

OF THE

COMMITTEE ON FINANCE

ON MARCH 5, 1984

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on March 5, 1984, by the Subcommittee on Energy and Agricultural Taxation and the Subcommittee on Oversight of the Internal Revenue Service of the Senate Finance Committee.

There are two bills scheduled for the hearing: S. 152 and S. 2180, both relating to tax credits for soil and water conservation expenditures.

The first part of this pamphlet contains a summary of the bills. This part is followed by a more detailed description of each bill, including present law and explanation of the provisions of each bill, and their effective dates.

I. SUMMARY

1. S. 152—Senators Jepsen, Boren, Armstrong, Symms, Heinz, and others

Tax Credits for Soil and Water Conservation

Present law permits taxpayers to deduct in the current year certain capital expenditures for soil and water conservation (sec. 175), for fertilizer, etc. (sec. 180), and for land clearing (sec. 182).

S. 152 would make certain expenditures for soil and water conservation on farmland eligible for the regular 10-percent investment credit. Amounts eligible for the investment credit would include soil and water conservation expenditures within the meaning of section 175(c) that the taxpayer does not elect to expense under section 175.

The provisions of the bill would apply to soil and water conservation expenditures made in taxable years beginning after December 31, 1982.

2. S. 2180—Senators Grassley, Symms, Boren, Pryor, Durenberger, Wallop, and Armstrong

Tax Credits for Soil and Water Conservation

Present law permits taxpayers to deduct in the current tax year certain capital expenditures for soil and water conservation (sec. 175), for fertilizer, etc. (sec. 180), and for land clearing (sec. 182).

Under S. 2180, a 20-percent tax credit would be allowed for expenditures by persons in the business of farming for soil and water conservation property (including certain irrigation property). The credit would be available only if the Soil Conservation Service certified to the Secretary of the Treasury that the expenditures were for improvements consistent with state-of-the-art conservation practices. Taxpayers would not be allowed to deduct under present sections 175, 180, or 182 any expenditure with respect to which a credit was claimed.

The provisions of the bill would apply generally to periods beginning after December 31, 1983.

(3)

II. DESCRIPTION OF THE BILLS

1. S. 152—Senator Jepsen, Boren, Armstrong, Symms, Heinz, and others

Investment Credit for Certain Soil and Water Conservation Expenditures

Present Law

A taxpayer can elect to deduct (i.e., expense) certain expenditures for the purpose of soil or water conservation that would otherwise be added to the taxpayer's basis in the land on which the conservation activity occurs (sec. 175). Such expenditures include amounts paid for items such as grading, terracing, and contour furrowing, the construction of drainage ditches, irrigation ditches, dams and ponds, and the planting of wind breaks. Also included are assessments levied by a soil or water conservation drainage district to the extent those expenditures would constitute deductible expenditures if paid directly by the taxpayer.

The cost of acquiring or constructing machinery or facilities that are depreciable may not be expensed. In the case of depreciable items such as irrigation pumps, concrete dams, or concrete ditches, the taxpayer is allowed to recover his costs only through cost recovery allowances and only if he owns the asset. Certain depreciable assets also are eligible for the regular 10-percent investment credit.

Certain costs incurred in connection with soil and water conservation are deductible as trade or business expenses without regard to section 175. For example, interest expenses and property taxes are deductible as current expenses. Similarly, the cost of repairs to a completed soil or water conservation structure are deductible as current expenses. Certain other capital expenditures made primarily to produce an agricultural crop are deductible expenses (secs. 180 and 182), but are not treated as soil or conservation expenditures under section 175, because such expenditures only incidentally may conserve soil.

The deduction for soil and water conservation expenditures under section 175 is limited in any one year to 25 percent of the gross income derived by the taxpayer from farming. Any excess amount is carried forward to succeeding taxable years.

Explanation of the Bill

Under S. 152, certain soil and water conservation expenditures would be made eligible for the regular 10-percent investment credit. Soil and water conservation expenditures with respect to which an investment credit could be claimed would be soil and water conservation expenditures eligible for the present expensing provision (sec. 175) that the taxpayer elected not to expense under

that provision. Thus, the taxpayer could not treat amounts expended for the purchase, construction, improvement, or installation of depreciable property as creditable soil or water conservation expenditures, but such property would continue to be eligible for the investment credit to the extent allowed under present law. In addition, amounts expended for soil or water conservation that the taxpayer elected to expense under section 175 would not be soil or water conservation expenditures eligible for the investment credit under the bill.

Effective Date

The provisions of the bill would apply to taxable years beginning after December 31, 1982.

2. S. 2180—Senators Grassley, Symms, Boren, Pryor, Durenberger, Wallop, and Armstrong

Investment Credit for Certain Soil and Water Conservation Expenditures

Present Law

A taxpayer can elect to deduct (i.e., expense) certain expenditures for the purpose of soil or water conservation that would otherwise be added to the taxpayer's basis in the land on which the conservation activity occur (sec. 175). Such expenditures include amounts paid for items such as grading, terracing, and contour furrowing, the construction of drainage ditches, irrigation ditches, dams and ponds, and the planting of wind breaks. Also included are assessments levied by a soil or water conservation drainage district to the extent those expenditures would constitute deductible expenditures if paid directly by the taxpayer.

The cost of acquiring or constructing machinery or facilities that are depreciable may not be expensed. In the case of depreciable items such as irrigation pumps, concrete dams, or concrete ditches, the taxpayer is allowed to recover his only through cost recovery allowances and only if he owns the asset. Certain depreciable assets also are eligible for the regular 10-percent investment credit.

Certain costs incurred in connection with soil and water conservation are deductible as trade or business expenses without regard to section 175. For example, interest expenses and property taxes are deductible as current expenses. Similarly, the cost of repairs to a complete soil or water conservation structure are deductible as current expenses. Certain other capital expenditures made primarily to produce an agricultural crop are deductible expenses (secs. 180 and 182), but are not treated as soil or conservation expenditures under section 175, because such expenditures only incidentally may conserve soil.

The deduction for soil and water conservation expenditures under section 175 is limited in any one year to 25 percent of the gross income derived by the taxpayer from farming. Any excess amount is carried forward to succeeding taxable years.

Explanation of the Bill

S. 2180 would provide a nonrefundable 20-percent investment credit for certain soil and water conservation expenditures. The credit would be available with respect to (1) qualified expenditures otherwise chargeable to the basis of the land on which the conservation activity occurs, (2) expenditures for qualified irrigation property, and (3) certain expenditures by district conservation authorities. The credit would only be available to persons engaged in the

business of farming the land on which the conservation improvements were made.

Types of qualified property

Qualified soil conservation improvements

Property that would be eligible for the conservation credit would consist of any improvements which were certified to the Secretary of the Treasury by the Soil Conservation Service as (1) consistent with state-of-the-art conservation practices and (2) making a major contribution to the conservation of soil or water on qualified land. It is understood that a separate certification would be made with respect to each conservation project for which a credit was claimed.

Eligible soil conservation improvements would include conservation tillage systems; contour farming; critical area pasture and hayland planting; diversion, floodwater retarding, and multiple-purpose dams; fencing for protection of conservation cover; field windbreaks; filter strips, grade stabilization structures; grassed waterways or outlets; livestock water pipelines; sediment control ponds and basins; stripcropping and terracing; tree planting for erosion control and/or conservation cover; waste management systems; or any other improvements specified under Treasury Department regulations.

Qualified irrigation property

As with qualified soil conservation improvements, expenditures for irrigation property would be eligible for the 20-percent credit provided under the bill only if the irrigation improvements were certified to the Secretary of the Treasury by the Soil Conservation Service as (1) consistent with state-of-the-art conservation practices and (2) making a major contribution to the conservation of soil or water on qualified land.

A credit generally would be available only for certain replacement irrigation systems and for equipment to modify existing irrigation systems to control water usage or soil erosion. Under the bill, expenditures for the following would be creditable: low-pressure precision application sprinkler systems or underground pipeline irrigation systems that replace surface irrigation systems; drip irrigation systems; automated surge-furrow irrigation systems that replace existing continuous flow systems; and gated-furrow-irrigation systems that replace open-ditch or siphon tube furrow systems. Additionally, the costs of automated systems that monitor soil moisture, flow meters, equipment to recirculate captured excess water, equipment to convert a sprinkler system to a low pressure precision application system, and other property specified in Treasury Department regulations would be creditable.

District conservation property

In addition to soil and water conservation property that was acquired directly by the taxpayer, the portion of assessments levied by a soil and water conservation district authority to finance qualified expenditures made by the authority would be creditable by the taxpayer paying the assessment.

Qualified land

Expenditures would be eligible for a conservation credit only if the expenditures were for otherwise qualifying improvements to land located in the United States which was owned entirely by a United States citizen and, as stated above, used by the taxpayer in the business of farming.

Coordination with certain expensing provisions

No credit would be allowable with respect to any expenditure for which a deduction was claimed under present section 175 (soil and water conservation expenditures), section 180 (fertilizer, etc. costs), or section 182 (land clearing expenses). In addition, in applying the present limitations on the maximum amount of those deductions under section 175 and section 182 (e.g., 25 percent of gross farming income under sec. 175 and the lesser of 5 percent of taxable farming income or \$5,000 under sec. 182), expenditures with respect to which a credit had been claimed would be treated as if the expenditures had been deducted. For example, if a taxpayer claimed a credit with respect to \$10,000 of soil conservation expenditures, the taxpayer would be treated as if the \$10,000 had been deducted under section 175 in determining the taxpayer's maximum allowable deduction under that provision. It is understood that the bill was not intended to expand the types of expenditures for which a deduction presently is available under section 175, 180, or 182.

Other rules governing the credit

Maximum amount of credit

The 20-percent conservation credit could not exceed 25-percent of a taxpayer's gross income derived from farming in any year. This limitation is in addition to the rules limiting investment credits generally to no more than 85 percent of tax liability in excess of \$25,000.

Credit not allowed for expenditures financed with nontaxable grants

No credit would be permitted with respect to conservation property financed with grants from the Federal Government, or a State or local government, to the extent that the grant was not included in the taxpayer's gross income when received.

Carryover of unused credit and basis adjustment

The rules permitting carryforwards and carrybacks of investment credits generally would apply to the credit for soil and water conservation expenditures. Additionally, an adjustment to the basis of the property equal to one-half of the credit amount would be required.

Limitation on cost recovery deductions

Cost recovery deductions for any irrigation property with respect to which an investment credit was claimed would be required to be computed using the straight-line method over the appropriate ACRS period rather than the accelerated method otherwise provided.

Recapture of credit in certain circumstances

The soil and water conservation credit would be recaptured if the taxpayer disposed of the land on which creditable improvements were made within 5 years after the conservation property was placed in service. In addition, the credit would be recaptured if the taxpayer claiming the credit ceased to carry on the business of farming on the qualified land within 5 years after that date.

Effective Date

The provisions of the bill would apply generally to periods beginning after December 31, 1983.

Senator GRASSLEY. I am Senator Chuck Grassley, and I will co-chair this meeting today, particularly in the absence of Senator Wallop who is Chairman of the Subcommittee on Energy and Agricultural Taxation. I want to thank Senator Wallop for his help in bringing attention to this issue of soil conservation. The two bills before us are S. 152, sponsored by Senator Roger Jepsen, and S. 2180, which I sponsored with the cosponsorship of my distinguished cochair, Senator Wallop. Five other colleagues of mine on this committee have joined the two of us in cosponsoring this bill. As evidenced by the efforts of the two Senators from my State of Iowa, soil conservation is a crucial issue to my State of Iowa as well as the entire Nation.

The rate of soil erosion and the effect of soil loss on the future productive capability of our land are serious issues for everyone in agriculture. Some analysts have questioned whether the lack of Federal and State attention to this growing problem will jeopardize our nation's efforts to meet future food needs, both domestically and worldwide. The increasing depletion of our soil is alarming because it shows a disregard for an important natural resource and indicates poor management of our nation's farmland. In 1982, the Council for Agricultural Science and Technology concluded that soil erosion was most severe in the twelve north central states. In the corn belt, soil losses of 10 tons per acre were common on 10 percent of row cropped land. On some parcels, the soil loss exceeded 40 tons per acre annually. Unfortunately, soil loss is not limited to these 12 States. In the Southeastern States, erosion rates of more than 11 tons per acre occurred on 32 percent of the land used for row crops. The highest soil erosion rates in the Nation are on the 26,000 square miles of the upper Mississippi Valley which includes the States of Tennessee, Kentucky, Mississippi, Louisiana, and Arkansas. Similar statistics show severe soil loss in the Mountain States and on the Columbia Plateau in the Pacific Northwest. Farmers' dramatic increases in crop yields have masked the damaging effects of soil and water erosion. In the CAST report, previously referred to, one scientist noted that studies with corn have shown a yield reduction of one to nine bushels per acre for each inch of topsoil loss. These losses are offset by the use of fertilizer and improving pest controls, but nevertheless, we cannot afford to gamble that the technology of the future will save us from our current inattention to this problem.

Economically, farmers have fallen upon very hard times. Many feel it is necessary to get the maximum production possible out of their soil merely to stay in business. Consequently, soil conservation efforts are suffering. In this climate, it is particularly appropriate that we provide greater incentives to farmers to assist them in preserving their soil. Senator Jepsen, my colleague from Iowa, is a recognized leader in the field of soil conservation, for as a member of the Senator Committee on Agriculture, he chairs the Subcommittee on Soil and Water Conservation, Forestry and Environment. His bill would permit taxpayers to claim a 10 percent investment tax credit for improvements currently eligible for the expensing contained within section 175. My bill permits farmers to claim a 20-percent credit for installing certain approved soil and water conservation practices, and the list contained in our bill was

recommended by the Soil Conservation Service. To enable the credit to remain compatible with the state-of-the-art advances, we have included regulatory authority to insert new technology. To address the criticisms of past soil conservation tax credit bills, we have narrowly defined eligible technologies and required the Soil Conservation Service to certify these improvements. Many of my urban colleagues have remarked that my previous efforts would have permitted a taxpayer to receive a tax credit for some urban improvements as well as ponds and planting trees in the front yards as a windbreak.

In an attempt to limit this tax credit to farmers who are actually earning their living farming rather than create a subsidy for sod-busters, we have inserted restrictions.

First, the total amount of soil conservation tax benefits cannot exceed 25 percent of an individual's gross income from farming. Therefore, passive investors who do not earn their living farming would not be eligible for the credit. Also, the bill requires certification by the Soil Conservation Service to be sure the recipients of the credit have employed a proper soil conservation technology.

Finally, to qualify for the water conservation of the credit, the eligible system must be a replacement rather than a new system to irrigate marginal land. These limits are important because the credit is very generous. It provides a 20-percent credit for these improvements and straight line depreciation. In my opinion and in the opinion of the six other Finance Committee Senators who have cosponsored the bill, soil conservation efforts merit a 20-percent credit. The problem is so serious we need a major incentive to encourage farmers to preserve their land now and for generations to come.

We are going to take our first witness out of order for the reason that Chuck Frazier, director of the National Farmers Organization, must be at a meeting at 2:30. I checked with Senator Jepsen, before he is scheduled to testify, and that is perfectly all right.

Chuck, as I said, is director of the Washington office of the NFO. He has been on the Washington scene since 1970, previous to that, he had extensive agricultural experience as an employee of ASCS before joining NFO.

Before you proceed, though, I would like to make an announcement that as a matter of usual procedure, that you summarize the statements, and that your statement—if you desire, and I hope you do—will be printed in the record in its totality.

Please proceed, Chuck.

STATEMENT OF CHARLES L. FRAZIER, DIRECTOR, NATIONAL FARMERS ORGANIZATION, WASHINGTON, DC.

Mr. FRAZIER. Thank you, Mr. Chairman. I would like for the whole statement to appear in the record. It is a pleasure to touch on the highlights in my statement because it would almost appear that we had collaborated. I agree with many of the points that you made in your earlier statements especially when you referred to some of the economic problems facing farmers today and the real interest rate with which we are still confronted, and the necessity

of a number of farmers to squeeze by on just as tight a budget as possible.

Turning to the bill and the subject at hand, we think your new bill is a substantial improvement over the one designed a year ago. It is justifiable—a more cautious approach—and we like the way you have put it together.

Referring to some of the same aspects that were brought out in the opening statement, I would like to emphasize two points. It would be most difficult to write specific definitions into the legislation. In fact, I do not suggest that that be done. I would urge that the history of the bill and the report on the bill emphasize for the benefit of the agency administering the program certain constraints or administrative guidelines. In local administration we would all hope that they would concentrate especially on the problems of those farmers and ranchers who are actually operating farm or ranch units for a living. In other words, let's help the mid-range ranchers and farmers upon whom we really depend for production in this country. They are economically hard pressed in many cases now. We would only like to emphasize that some attention should be given to their plans, their problems, the assistance that they may require to carry out practices qualifying for this deduction on the tax forms. At least, they should be given some preference over investment-type operators that are picking up several thousand acres of land at a whack on the high plains and farming primarily as a tax dodge, looking forward to taking capital gains at some point in the future.

Our testimony and our interest in your bill in this case are in keeping with the statements that we made last fall on the House side when they were considering the problems involving breakup and farming of fragile lands. I think we have a rather long-standing record of supporting all reasonable conservation steps that this Government may take in assisting the real farmers and ranchers. And with that, sir, I appreciate the opportunity to be here, and I especially appreciate your courtesy in letting me appear quickly on today's schedule.

[Mr. Frazier's prepared statement follows:]

Subcommittees on Oversight
of the Internal Revenue
Service and Energy and
Agricultural Taxation
Finance Committee
United States Senate

STATEMENT
CHARLES L. FRAZIER
Director, Washington Office
NATIONAL FARMERS ORGANIZATION
March 5, 1984

Chairman Grassley, Chairman Wallop, and members of both subcommittees, on behalf of the membership of the National Farmers Organization, I would like to thank you for this opportunity to testify before you on S. 152 and S. 2180, introduced by Senators Jepsen and Grassley, respectively. These bills, which provide investment tax credits to farmers who carry out certain conservation practices, constitute a sound, if limited, response to the difficult situation we are in right now. Unless measures like this are taken quickly, the U.S. conservation effort will come to a virtual standstill, and may even begin to backslide.

This dangerous condition has been brought on by a combination of two developments, the first of which is the distressed plight of the farmer. The Payment-in-Kind (PIK) program may have brought temporary financial relief to some producers, but it has done nothing to retard the steady decline of the family farming system in this country. Net farm income peaked at \$32 billion in 1979, and decreased to \$22 billion in 1982. PIK program benefits and the attendant reduction in input expenditures boosted farm income on paper to \$24 billion in 1983, but even that short term measure failed to prevent thousands of additional farmers from going

out of business. In the absence of an attractive wheat and feedgrains program covering the current crop, economists are already predicting silo-busting harvests this Fall, with price effects which can easily be imagined. When one adds to this gloomy prognosis the near-certainty of continued high interest rates, one begins to see why we should be so concerned about conservation.

In a time of financial uncertainty and stress, many farmers are just trying to survive through next year. Conservation of soil and water resources is high on the list of priorities of all farmers, but in the short term it is regarded as an expense which doesn't increase output and which can't be passed along in the marketing chain.

The second development which concerns us is the retreat by USDA from the conservation effort. Since 1980, the Administration has requested deeper and deeper budget cuts for this item. In FY 1983, the budget for USDA's combined conservation activities stood at \$1,092 million. The 1985 budget requests a sum of \$725 million, a cut of 34%. No amount of "targeting" can disguise this as anything but a withdrawal from conservation. Like the very big deficits, soil and water erosion will come back to haunt us before long.

To sum up, what we have is a situation in which the farmer is unable and the government unwilling to do enough to prevent the further deterioration of our most valuable resource base: land and water. Without citing rows of statistics, I would only remind members of the subcommittees just how serious the erosion problem is, especially in the Midwest. It is perhaps appropriate that both of the bills we are examining today are sponsored by Iowans, for the officeholders from that state are well-known for their leadership in drawing national attention to this problem.

The Internal Revenue Code already permits limited deductions for farmers who incur conservation related expenses. Unfortunately, those provisions have also proven attractive to investors seeking tax shelters, as well as to the farmers for whom they were intended. Indeed, last Fall we testified before the House Agriculture Committee on how the conscious manipulation of agricultural investment credits by savvy money market managers contributes to the "sodbusting" of fragile lands, as well as adding to commodity surpluses.

S. 152 and S. 2180 represent attempts to increase the financial incentive for producers to carry on conservation practices. The number of cosponsors indicates broad-based, bipartisan support which, we hope, will help ensure passage. Also, the list of expert witnesses whom I am honored to join constitutes an impressive endorsement of the technical soundness of this legislation.

Senator Grassley's bill in particular represents a thoughtful, cautious approach, as it is a revision of similar legislation introduced by him last year, which accomodates suggestions made at that time to tighten up the eligibility and, thus, prevent the abuses I alluded to earlier. This bill, in effect, would create a cost-share type program similar in approach to the ACP program, which is highly popular with farmers. As a long-time observer of the USDA agencies in conservation work, I can testify from first-hand knowledge to the successful results of this flexible program.

The revenue tool employed in this bill consists of tax credits, as opposed to deductions. Due to the progressive structure of the tax code, credits would seem to be far more beneficial to individuals in lower income brackets. On the

surface, this appears to serve the need of farmers in strained financial conditions, who most need this form of assistance. But a couple of questions arise as to how such credits would be applied in practice: firstly, large, established operations are already able to shelter income and otherwise reduce their tax exposure through a vast array of loopholes.

We hope the legislative history will be clear on any bill you bring out that these provisions are designated to aid producers who are actually farming the land for a living.

Secondly, we have some reservation also with respect to the irrigation references. Although we do not propose to change the language in the bill, hereto we urge that the administering agency be given guidance in the Report on the bill. These provisions should not be used to accelerate aquifer depletion and ground water contamination. It is hoped that any forthcoming bill will not simply make expanded irrigation more financially feasible, and thus have the unintended effect of adding to the surplus problem in a number of commodities.

Generally, though, we are pleased by a number of provisions in the Grassley bill which are aimed at curbing abuse and manipulation of the tax code by non-farming individuals. The application of carryback and carryover rules are particularly important in a time when many farmers are just breaking even or operating at a loss. It may prompt some producers to go ahead with a project right now, rather than waiting for a year in which they could take the tax credit. The listing of specific conservation activities and requirement of Soil Conservation Service certification should prevent people from being able to claim swimming pools and decorative fencing as creditable expenses. Finally, we support those sections

of the bill which prevent double-dipping and discourage those in search of tax shelters.

In sum, the National Farmers Organization endorses the concept embodied in this bill; namely, that conservation outlays are just as much a part of farming as equipment expenses, and should be treated in like fashion under the tax code. We hope that members of the subcommittees will consider the questions we have raised, and favorably report legislation which provides an opportunity for the family owned and operated farm to preserve land and water for coming generations.

Senator GRASSLEY. Do you have time for a couple of questions?
Mr. FRAZIER. Surely.

Senator GRASSLEY. You already spoke to the point that we are trying to make that those people actively engaged in farming—as opposed to the passing investor—will be the ones to be able to make use of the technology and the credit that follows it. Excuse me, I should say through the use of the technology make use of the credit.

Now, as one way, we have limited the benefits to 25 percent of the gross income from farming. The water conservation portion of the tax credit is limited to replacing existing technologies, so that we don't have the sobduster problem that sometimes Government programs and tax credits encourage. Of course, then, we must have SCS certification to make certain that an effective technology is subsidized. In your view, will this combination of protections prevent investor abuse that you spoke of?

Mr. FRAZIER. Certainly, those provisions are improvements in the legislation, and they will contribute toward that end. Perhaps I have not said it well, but to support the technical provisions of the bill, I believe it is also important that the SCS Administrators be specific, and be reminded of—you might say—a sense of priorities as they extend assistance to the ranchers and farmers who are trying to install these practices and qualify for their tax deductions.

To us, it is rather a crying shame that some of these partnerships that are being formed today can go out there and buy 5,000 and 10,000 acres at a crack on the high plains, break them up, and actually use our Government price support programs and several other provisions of law that are well intended for farmers, specifically to enhance their tax writeoffs against what they are making in Chicago, New York, or otherwise.

So, I think you are on the right track, and I am only speaking of—you might say—the spirit of the thing and the record that may be made in your hearings and in the reports on the bill.

Senator GRASSLEY. In our emphasis upon those who are actually engaged in farming and the fact that we leave the investor—the passive investor—out of taking advantage of it, are we, in your judgment, doing harm to the cause of soil conservation, assuming that those people might be investing money in soil conservation? I don't know whether we can assume that or not, but I suppose we would have to assume it for my question to have any relevancy at all.

Mr. FRAZIER. No, I think you are taking a fair and proper approach in the matter. I think that as we review farm bills in 1985, and as we go over all of these matters, we have to concentrate our attention on the mid-range producers, out there on the land. We are losing too many of them, as the chairman so very well knows. So, I think you are on the right track.

Senator GRASSLEY. One last question, then. As you know, of course, this bill permits the soil conservation tax credit to be carried forward or backward—like the investment tax credit. It is the first soil conservation tax credit bill to include this provision. Will this provision be helpful, not only to your members, but to farmers generally, particularly because many of them have experienced loss years and may not be able to use the credit currently?

Mr. FRAZIER. Yes, sir. As a matter of fact, we noted that in our testimony and endorsed the provision, sir. I think it is a good one.

Senator GRASSLEY. All right. I thank you and I am glad you could come, even though you have a busy schedule. And I hope that you make your 2:30 meeting.

Mr. FRAZIER. Thank you ever so much.

Senator GRASSLEY. I am happy now to welcome my colleague, Senator Jepsen. Senator Jepsen, in my opening statement, I spoke of your contribution to soil conservation through not only your legislation but also your chairmanship of the Subcommittee on Soil Conservation, so I won't go into any more detail on that. I will ask you to proceed now.

STATEMENT OF HON. ROGER JEPSEN, U.S. SENATOR FROM THE STATE OF IOWA

Senator JEPSEN. I thank you, Mr. Chairman. I am very pleased that we are having this hearing today to examine the effectiveness of using the Tax Code to provide incentives to farmers for soil and water conservation expenditures.

I know that you share my concern that the continued excessive soil loss in this country is unacceptable. Reducing excessive erosion from wind and water damage remains a national resource priority that we in Congress must continue to keep our commitment to addressing.

I did introduce and file Senate bill 152, the Soil and Water Conservation Incentives Act of 1983, early last session. This act would allow private landowners and operators, as well as tenants and absentee landowners, to claim a 10-percent investment tax credit when they invest their own money to install and maintain conservation practices on their lands. This legislation builds on section 175 of the U.S. Tax Code, which allows farmowners or operators to deduct certain land management and conservation expenditures.

My bill would allow for a choice of either a full tax deduction the year the structure is installed or a 10-percent investment tax credit the first year, with deductions that year and thereafter on a standard depreciation schedule. For example, a farmer uses his or her own money to install an erosion control structure at a cost of \$2,000. My bill will allow, first, a deduction of \$2,000 from the farmer's gross income that taxable year, or second, a \$200 tax credit—10 percent—off the tax liability that taxable year with deductions thereafter amounting to the full cost of the structure over the span of its appreciable life. This legislation would also be cost effective. In April of 1983, I requested the Joint Economic Committee on Taxation to provide a revenue statement of Senate 152, and the joint committee in its response stated that, if Senate 152 is enacted, the costs to the Treasury would be approximately \$6 million the first year, and between \$16 and \$22 million every year thereafter through 1988. I ask that the letter from the Joint Committee on Taxation be printed in the record following my remarks, and I would ask unanimous consent that that letter from the joint committee be printed in the record.

Senator GRASSLEY. It will be at this point.

Senator JEPSEN. Mr. Chairman, this legislation is significant because it does reward individual initiative in planning soil and water conservation systems. This legislation would allow a tax credit on conservation expenditures which are not now permitted under section 175 because they either exceed 25 percent of gross farm income or because the persons incurring the expenditures have no income from farming. Mr. Chairman, you and I both were among the first to introduce conservation tax legislation both in this and the 97th Congress. I do hope we can get some constructive comments on our ideas during this hearing today, and with those comments, move this legislation through the Congress with expediency.

As you know by personal observation, Mr. Chairman, when you leave your farm and drive into Cedar Falls on Highway 20, as you drive past the Jepsen homestead—approximately 3 miles west of Cedar Falls—you will find terraces that are there—I won't say in abundance—but they are there in place, and these were done without any tax incentives. However, we value our farming operation. The soil and the need to conserve it, we feel, has been a personal responsibility throughout generations of our family. And I do know that most farmers are very concerned with soil conservation and would do everything possible to make sure that the stewardship of the soil is tended to in a proper manner. Having a tax incentive to do so, I think, is justifiable, and is certainly part of a national commitment that we need, and must have, for the stewardship of our soil in this land, which is a natural resource we are blessed with. And with that blessing, not only do we have the responsibility of utilizing it for the benefit of all mankind by way of producing food, but we also have the responsibility to preserve it and take care of it. And that is what we are effectuating here. And I thank you, Mr. Chairman, for making this hearing possible and for all of your work throughout the years. You have been at it a good number of years both in the House, in your very distinguished service as a Congressman, and now in the Senate. Thank you very much.

[Senator Jepsen's prepared statement follows.]

STATEMENT OF
SENATOR ROGER W. JEPSEN (R-IOWA)

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

MARCH 5, 1984

THANK YOU MR. CHAIRMAN. I AM VERY PLEASED THAT WE ARE HAVING THIS HEARING TODAY TO EXAMINE THE EFFECTIVENESS OF USING THE TAX CODE TO PROVIDE INCENTIVES TO FARMERS FOR SOIL AND WATER CONSERVATION EXPENDITURES.

I KNOW THAT YOU SHARE MY CONCERN THAT THE CONTINUED EXCESSIVE SOIL LOSS IN THIS COUNTRY IS UNACCEPTABLE. REDUCING EXCESSIVE EROSION FROM WIND AND WATER DAMAGE REMAINS A NATIONAL RESOURCE PRIORITY WE IN CONGRESS MUST CONTINUE TO KEEP OUR COMMITMENT TO ADDRESSING THIS PRIORITY NEED.

I INTRODUCED S. 152, THE SOIL AND WATER CONSERVATION INCENTIVES ACT OF 1983 EARLY LAST SESSION. THIS ACT WOULD ALLOW PRIVATE LANDOWNERS AND OPERATORS, AS WELL AS TENNANTS AND ABSENTEE LANDOWNERS, TO CLAIM A 10 PERCENT INVESTMENT TAX CREDIT WHEN THEY INVEST THEIR OWN MONEY IN INSTALLING AND MAINTAINING CONSERVATION PRACTICES ON THEIR LANDS.

THIS LEGISLATION BUILDS ON SECTION 175 OF THE U.S. TAX CODE WHICH ALLOWS FARMOWNERS OR OPERATORS TO DEDUCT CERTAIN LAND MANAGEMENT AND CONSERVATION EXPENDITURES.

MY BILL WOULD ALLOW FOR A CHOICE OF EITHER A FULL TAX DEDUCTION THE YEAR THE STRUCTURE IS INSTALLED OR A 10 PERCENT INVESTMENT TAX CREDIT THE FIRST YEAR, WITH DEDUCTIONS THAT YEAR AND THEREAFTER ON A STANDARD DEPRECIATION SCHEDULE.

FOR EXAMPLE, A FARMER USES HIS OR HER OWN MONEY TO INSTALL AN EROSION CONTROL STRUCTURE AT A COST OF \$2,000. MY BILL WILL ALLOW, FIRST, A DEDUCTION OF \$2,000 FROM THE FARMER'S GROSS INCOME THAT TAXABLE YEAR; OR

SECOND, A \$200 TAX CREDIT -- 10 PERCENT -- OFF THE TAX LIABILITY THAT TAXABLE YEAR WITH DEDUCTIONS THEREAFTER AMOUNTING TO THE FULL COST OF THE STRUCTURE OVER THE SPAN OF ITS APPRECIABLE LIFE.

THIS LEGISLATION WOULD ALSO BE COST EFFECTIVE. IN APRIL OF 1983, I REQUESTED THE JOINT ^{ECONOMIC} COMMITTEE ON TAXATION PROVIDE A REVENUE STATEMENT OF S. 152. ^{IN} THE JOINT COMMITTEE IN ITS RESPONSE STATED THAT IF S. 152 IS ENACTED THE COSTS TO THE TREASURY WOULD BE APPROXIMATELY 6 MILLION THE FIRST YEAR, AND BETWEEN 16 AND 22 MILLION EVERY YEAR THEREAFTER THROUGH 1988.

I ASK THAT THE LETTER FROM THE JOINT COMMITTEE ON TAXATION
BE PRINTED IN THE RECORD FOLLOWING MY REMARKS.

MR. CHAIRMAN, THIS LEGISLATION IS SIGNIFICANT BECAUSE IT REWARDS
INDIVIDUAL INITIATIVE IN PLANNING SOIL AND WATER CONSERVATION
SYSTEMS. THIS LEGISLATION WOULD ALLOW A TAX CREDIT ON
CONSERVATION EXPENDITURES WHICH ARE NOT NOW PERMITTED UNDER
SECTION 175, BECAUSE THEY EITHER EXCEED 25 PERCENT OF GROSS
FARM INCOME, OR BECAUSE THE PERSONS INCURRING THE EXPENDITURES
HAVE NO INCOME FROM FARMING.

MR. CHAIRMAN, YOU AND I BOTH WERE AMONG THE FIRST TO INTRODUCE
CONSERVATION TAX LEGISLATION BOTH IN THIS AND THE 97TH CONGRESS.
I HOPE WE CAN GET SOME CONSTRUCTIVE COMMENTS ON OUR IDEAS DURING
THIS HEARING TODAY, AND WITH THOSE COMMENTS MOVE THIS LEGISLATION
THROUGH THE CONGRESS WITH EXPEDIENCY.

86TH CONGRESS 1ST SESSION

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Congress of the United States

JOINT COMMITTEE ON TAXATION

1018 LONGWORTH HOUSE OFFICE BUILDING

Washington, D.C. 20515

APR 11 1983

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 DEPUTY CHIEF OF STAFF (ECONOMICS)

Honorable Roger W. Jepsen
 U. S. Senate
 Washington, D.C. 20510

Dear Senator Jepsen:

Chairman Rostenkowski has asked that we respond to your request for a revenue estimate of S. 152, the Soil and Water Conservation Incentives Act of 1983.

The Act would allow investment tax credit on those conservation expenditures which are not allowed now under section 175 because they either exceed 25 percent of gross farm income, or the persons incurring the expenditures have no income from farming. After reviewing the estimate that was prepared in 1981 and covered the same provisions, we have lowered the revenue cost figures to reflect a slower growth in prices than we had assumed when making the estimates two years ago. Our current estimate is shown below.

<u>Fiscal Years</u>					
<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
(Millions of Dollars)					
-6	-16	-18	-18	-20	-20

If the Act were to become Public Law after mid-September, too late for its revenue effects to be reflected in estimated payments made during the current fiscal year, the figure shown for 1984 would increase to \$22 million, and there would be no revenue loss in 1983.

Sincerely,



David H. Brockway

Senator GRASSLEY. Thank you. If I could—before you go—I would like to have for the benefit of my colleagues as well as the public at large—who maybe would not compare the hearing record that we are establishing here with what you have already done so many times in your subcommittee—I would just like to have some sort of general summarizing statement from you, as to the gravity of the problem of soil conservation, so that there is no doubt in the public's mind from an authority like you, as to what the problem is that we are trying to address here.

Senator JEPSEN. Wind and the water erosion reduces the amount of topsoil on farmlands by about 6 billion tons annually. In Iowa, the average rate of topsoil loss is almost 10 tons per acre, per year. In the Corn Belt, the amount of soil erosion is double that of any other region in the United States. Department of Agriculture statistics show that sheet and real erosion in the Midwest leads to over 650 million tons of soil loss annually, and erosion from wind averages over 7 tons of soil loss per acre, per year.

In our State of Iowa, we are the leading State in the production of livestock and corn. We are second in soybean production, and with more than \$10 billion annually in sales, Iowa is second in gross farmer receipts. If erosion continues at the present rate—without our Federal programs—the country would face enormous productivity losses. So, whereas we made some improvement, Mr. Chairman, on controlling and working on wind and water and soil erosion, we still have in our home State an average loss that is more than twice the amount that experts say that the soil can stand by way of replenishing and replacing itself.

Senator GRASSLEY. Thank you very much for that statement. One other question, if I could please, and that would be, again, a sort of general account—a comment from you—of how you view the things you are working on in the way of authorizing legislation, whether it be reauthorization or new legislation—how that dovetails in with the tax credit approach and what we are trying to do here—whether or not it works out nicely. Maybe it might create a competitive environment that we don't want, or maybe a competitive environment we do want. Just any sort of general comment as you view the traditional approaches that have been used through ASCS programs and SCS programs for the last 40 years and the tax credit approach.

Senator JEPSEN. First of all, I think with specific reference to your tax bill and the tax bills we have to supplement the subcommittee's efforts, I think, as a matter of fact, they will. I am working with the General Accounting Office to consider a full audit of the Tax Code, not just conservation titles of the code, but the commodity titles as well. The tax advantages provided by the commodity programs sometime undermine conservation program goals. So, this audit will be conducted in cooperation with an ongoing study now being prepared by the Joint Committee on Taxation on conservation tax laws. I would say, Mr. Chairman, that by holding this hearing, you are opening the dialog for some constructive comments on how to proceed in this area. I look forward to reviewing the transcript of the hearing and using that information. As you may be aware, tomorrow, March 6, the subcommittee is holding its annual oversight hearing on the department's conservation budget,

and on the department's progress in implementing the National Conservation Program. Like many of our entitlement programs, funding for soil and water conservation is proposed at a substantially lower level than Congress appropriated in 1984, but I expect Congress will provide a higher level of funding as usual. However, as we seek to lower Federal expenditures and reduce the deficit, sacrifices are going to have to be made in all areas. Therefore, during the hearing tomorrow, I am going to focus—not solely on the magnitude of the reductions but also on the actual program changes and changes in the level of the quality of service delivered to the farmers because of these cuts.

And I might add, in closing, that I have really given a very broad, encompassing answer to your question. In addition, the subcommittee may schedule hearings sometime in April on Senate bill 2195—that is a bill I introduced last year that provides for long-term reserves for soil and water conservation programs. Other efforts will focus on planning for the 1985 farm bill. The subcommittee will explore specific proposals to integrate the objectives of soil conservation programs with the Department of Agriculture's commodity programs. We have to develop our soil conservation programs just as we have to develop all of our farm programs on the basis of consensus, rather than conflict.

There is a direct tie and relationship to the various farm programs that, in the past, have not been properly considered. The commodity programs, for example, have encouraged farmers to make hay, so to speak, while the Sun shines, and pull up the fence rows and cultivate the soil. In fact, with the internationalization of agriculture in the 1970's—as we know in Iowa—we have had fragile land plowed up in southern Iowa that was done so, frankly, because of the incentive that was given by the feed grain programs on a national basis. I think that is evident now—as we cope with hard financial times, the drought, and low yields and so on, that these incentives were not a very good idea, not just because of increased soil erosion. There is also something about stewardship that goes along with the diversified farming operation that your father and mine and our grandfathers and so on, practiced as they were farming years ago. There was some natural conservation that took place with the diversification and the rotation of crops that we needed, carried in the soil. Even without the modern technology that we still had back then, we in many instances had a lot less soil erosion in those days than we do now with all the modern techniques and knowhow we have.

Minimum till and no-till are, as you know, advancing very rapidly in acceptance in our State of Iowa, and I am pleased with the progress that is being made in that area. Where you can save toil and soil and oil with minimum till practices, and I think that is one of the things that we have got to look forward to in the future—as an answer partially to our financial problems as well as the soil conservation problems in agriculture. We have got to learn to produce something at lower production costs. With the credit crunch, the interest rates, and trying to compete in the world markets, if we can produce something for 50 cents a bushel less, that will be like finding 50 cents a bushel on the top side by way of payment to the producer. We need to try to produce agricultural goods

for 50 cents a bushel or \$1 a bushel less and at the same time conserve our soil. Those are the types of goals that we need to be shooting for. And I can assure you that we are looking at how to accomplish this in my Subcommittee on Conservation and discussing this in the hearings that I have held throughout the country on conservation issues.

Senator GRASSLEY. Thank you very much.

Senator JEPSEN. Thank you, Mr. Chairman.

Senator GRASSLEY. Particularly for your continual working relationship on this piece of legislation.

Senator JEPSEN. Thank you.

Senator GRASSLEY. I would like to call now our next witness, Jim Miller, assistant legislative director for the National Grange. Mr. Miller is a native of the State of Colorado and holds a master's degree in political science and public administration. Before coming to the Grange, he worked for the State of Colorado on soil and water conservation projects. I hope we are right on that.

Mr. MILLER. I am surprised.

Mr. GRASSLEY. All right. Would you proceed then as we previously had stated that we ask our witnesses to?

**STATEMENT OF JAMES MILLER, ASSISTANT LEGISLATIVE
DIRECTOR, NATIONAL GRANGE, WASHINGTON, DC**

Mr. MILLER. Thank you, Senator. I appreciate the opportunity to be here today, and I think that you and Senator Jepsen are to be commended for your efforts in this regard. We support the investment tax credit for soil conservation and erosion control, and I think I ought to make the point, too, that—while we do support this investment tax credit—we think it is necessary to view this in terms of one tool in a very diversified array of tools that are available to approach the problem of soil and water conservation. I don't think that investment tax credits could ever take the place of our ongoing programs.

Basically, I took a look at the bills in question and I had to admit my inability to understand a lot of the complexities of the tax issues and the like, but I do understand that there are some efforts to target the tax credit to bona fide owner-operator farming units, and we certainly commend that. I think the discussion that occurred with Mr. Frazier prior is an important one and certainly sums up the concept to which we ascribe as well, that being what farming does not need is another latent tax shelter to draw in non-farm income. And it certainly is becoming increasingly necessary, I think, to look at any favored tax treatment for agriculture as that potential, and if I understand the bill that you have introduced, Senator, I think I see that aspect and that very necessary targeting provision.

Let me also say that, in terms of investment tax credits for water conservation, we have some difficulty with the concept. We don't have any difficulty with the idea of conserving water. Certainly, that is not to be interpreted from my remarks. However, first, we have concerns that there may be an enormous burden on the Treasury. I have not seen any figures in that regard. It is simply a feeling or an assumption that I have made. And second, I think

that it is important—and there is an issue brought out in my testimony—that the possibility exists for other forms of water conservation to occur irrespective of the Tax Code. The Imperial Irrigation District has entered into discussions with the Metropolitan Water District of Southern California that are indicative of that. There are efforts to conserve water in some of the most arid areas of the country, and I think that this can occur without reliance on a tax credit.

We are, again, concerned that there would be far fewer beneficiaries of a water conservation investment tax credit than there would be for soil conservation. So, I simply want to raise the issue for further discussion and hope that this would come to light during markup and discussion of the bill. I am pleased to be here and enjoy working with the committee and with the other subcommittee.

[Mr. Miller's prepared statement follows:]

national grange

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WASHINGTON, D. C. 20006

(202) 628-3507



STATEMENT OF JAMES MILLER
 Assistant Legislative Director, the National Grange
 before the
 Subcommittee on Energy and Agricultural Taxation
 Subcommittee on IRS Oversight
 of the
 Senate Committee on Finance

RE: S. 152 and S. 2180 To Provide Tax Credits For
 Soil and Water Conservation Expenditures

March 5, 1984

Chairmen Wallop and Grassley:

On behalf of the National Grange and the nearly 400,000 Grange members nationwide, I am pleased to appear before you today to offer the Grange's opinions on the two bills pending which would grant investment tax credits for soil and water conservation.

The National Grange supports a 10% investment tax credit for soil conservation and erosion control. In our opinion, such a tax credit would be a useful addition to our efforts to protect our nation's most precious resource -- our ability to feed this nation and millions of the world's population. While science has enabled farmers and ranchers to enhance productivity through genetics, chemicals, and other technologies, our fundamental advantage lies in America's fertile soil resources.

It should be stated that in the Grange's opinion, tax credits for resource conservation will not replace the other programs sponsored or supported by government at all levels. We must continue to support the ongoing programs of the Soil Conservation Service and the Agricultural Stabilization and Conservation Service in order to maintain an overall conservation effort in this country. But tax credits should be adopted to aid in this important task.

I have not had the opportunity to examine and study the two proposals under consideration today to the extent that I would have liked. I am neither an attorney nor a tax specialist. But in reading the bills, several questions came to mind, and I would like to take advantage of this opportunity to raise them for your consideration during the mark-up process. The bulk of my comments relate specifically to details contained in S. 2180, but could be applicable to S. 152 as well.

1. It appears from the language on pages 2 and 3 (of S. 2180) that the effort is made to place limits on the amount of tax liability which conservation credit may be applied. If my understanding is correct, the Grange supports this effort, but more time is needed to determine the impact of the limits the bill assigns. In addition, the language on page 3, line 21 would indicate that only income derived from farming per se is eligible for the credit. Again, we would support this effort to target the tax benefits.

In recent years, the National Grange has become increasingly concerned that provisions in the tax code are having widely divergent effects on agriculture as an entire industry. We are therefore finding it increasingly difficult to support

-2-

avored tax treatment for agriculture if such benefits are not viewed in terms of how medium sized, owner operated farming units will fare under the terms of the proposals. We have learned that other tax benefits, which we have supported in the past, have served to attract much nonfarm income into agricultural investments. We are further convinced that the tax code is, in part, the cause of some of our current commodity surpluses and has contributed substantially to farm consolidation at the expense of the smaller, yet efficient, farmer-operator.

2. In regards to the provisions of the bills that would grant the tax credit for water conservation, the Grange would raise the point that the benefits of water conservation, for the most part, would accrue directly to the landowner in the form of increased productivity. We are of the impression that the investment tax credits should be limited to long-term soil and erosion control. The bill would reward improved irrigation efficiency that could result in erosion control, and in that sense, we would support the benefits. But it goes further by allowing for landowners to claim credit for assessments by a district (drainage or irrigation). The intention here is to conserve water resources.

The Grange takes exception to this proposal not on the basis that water conservation is not desirable, but rather, we see this as potentially costly to the federal treasury with very few benefit recipients. In the most arid areas of the country, water conservation could eliminate the need for expensive water development projects to serve municipal and industrial users. Clearly, making the best use of this resource is in the public interest. However, the use of tax credits may not be necessary.

I would point out one encouraging example of how major irrigation project efficiency can be achieved in partnership with M and I users. The Imperial Irrigation District in California has entered discussions with the Metropolitan Water District of Southern California to effect what amounts to a trade of water. The M&I users would finance all or a portion of IID's water conservation improvements and would receive the saved water in return. This is encouraging and the use of tax credits may or may not have resulted in a similar event. Perhaps a structural approach to water use could result in far greater water savings than tax credits could produce.

In 1982, Congress took some initial steps of addressing the structural implications of water conservation. The Reclamation Reform Act will begin to show water conservation improvement because it will have the effect of raising the cost of some reclamation project waters in certain areas of the country. Perhaps Congress should wait to view the effects of the new reclamation law before taking this expensive step of allowing tax credits. That law requires that irrigation districts develop water conservation plans, containing definite goals and measures along with a time schedule for meeting the water conservation objectives. Consideration of these plans might lead to a method of water conservation assistance more in keeping with agricultural production in all areas of the country.

The benefits of improved irrigation efficiency will accrue directly to the landowner, and we do not feel that this should be financed with taxpayer dollars. The ASCS programs that provided cost-sharing for subsurface tilling for drainage and for liming agricultural land have been discontinued for this very reason. We feel that this was an appropriate move, and the precedent is established and applies to some of the irrigation projects that would be eligible under these bills.

I am pleased to be here today, and I look forward to working with this Committee on this and other subjects in the future. I would be happy to answer any questions you might have.

Senator GRASSLEY. Is the last statement you made—where you said that there would be more beneficiaries because of soil conservation than because of water conservation—is that directly related to the minority of the farmers who must use water conservation and irrigation and things like that? Is that what that is based on?

Mr. MILLER. Yes; in part, that certainly irrigated agriculture is in the minority. However, it is an increasingly frequent occurrence, and it certainly is not limited to the arid areas of the West either. It is becoming more and more a fact of life in some of the Corn Belt States—as you are aware—simply because it does further eliminate the risk of drought. More behind that statement, Senator, was a feeling that some of the very large water conservation projects that—particularly through the assessment provision that the bill would allow to recapture that credit on the assessments—could be enormously expensive, particularly in those very large irrigation districts in the West. Massive undertakings, particularly to enclose a conveyance system for instance; the overall budget impact of this might be much more severe.

I would be very interested in seeing some projected figures on that. I don't know how it would even be possible to arrive at those in the immediate future.

Senator GRASSLEY. In a very general way, do you feel that the water conservation provisions of this bill address problems that your members have—those that fall into that category?

Mr. MILLER. Yes; it does. It would address those issues. However, it is a very fine line to draw, and I admit this very much up front—to make the distinction between the value of saving soil as opposed to the value of saving water. Our reluctance to get behind the investment tax credit for irrigation efficiency is simply based in the fact that the benefits that would accrue to the landowner by increasing the efficiency of his irrigation system would be directly on the farm, whereas the benefits to soil conservation would have some nonfarm impact. But in the long run, I think, that society would benefit. It is a philosophical difference, I guess.

Senator GRASSLEY. I guess the only place where I might ask you to reconsider would be in those areas where we know we are mining water, as opposed to making use of recycling.

Mr. MILLER. That is an important point. It certainly is.

Senator GRASSLEY. Where the supply of drinking water is based upon the aquifers that we are pumping down. It seems to me that that also has as great a social aspect as it does keeping the soil on the farms instead of in our streams.

Mr. MILLER. I agree. And those are specific cases, and they are very, important cases, too. Certainly, the Ogalala is a excellent example of that. We are continuing to take a look at both of the bills in question and, hopefully, as these hearings progress and more information is available, we would like to get back to you.

Senator GRASSLEY. I would also like to ask a question similar or the same as I asked Chuck Frazier of the NFO. Your views on our antipassive investor type provisions of the legislation, and the great extent we went to by having the 25-percent limitation on gross income. Also, SCS certification, so that we get the benefit of this legislation to those people that are involved in agriculture.

Mr. MILLER. Those are certainly important aspects, and in retrospect, I wish the efforts had been made in previous tax bills that were passed that targeted the effort that you have made on this one. I think it is important. I think it is significant, and it appears, anyway, from my knowledge—and as I said, we are looking into this—those targeting techniques that would be effective.

Senator GRASSLEY. And do you see any negative aspects of it? Like I suggested to Mr. Frazier, maybe if we really view soil conservation to be such a major problem that we need a tax credit, maybe we shouldn't discourage those people who are passive investors from making use of it as well, as long as the end result of keeping soil on the farms is accomplished.

Mr. MILLER. I think there is potential for that. Simply a quick overview of landowner statistics in this decade would indicate that increasingly more agricultural land is, in fact, owned by passive investors, or certainly investors who are not on the farm. Perhaps there is some room to lose some benefit by that targeting technique. However, I think that running the risk of losing that portion of people who might contribute to the overall soil conservation effort I am not sure would be offset in building in another incentive to hold that land and keep it as an investment opportunity, rather than some attempt to farm that land and make a living off of farming the land as opposed to owning the land.

Senator GRASSLEY. A greater social benefit from the latter is the position you are taking?

Mr. MILLER. Yes.

Senator GRASSLEY. Coming from Colorado—I wasn't reminded of this until remembering my introduction of you—however the problem that we referred to as sodbusting tends to be more of a Great Plains State problem. Do you see this, from your expertise and your knowledge of that area, as helping solve that problem?

Mr. MILLER. You mean, per se—

Senator GRASSLEY. Yes, again with the emphasis upon the active farmer, as opposed to the passive investor.

Mr. MILLER. There is no doubt. Sodusting is a big problem, and I come from part of the State where that generally occurred—at least where the first part of it started. It does bother us significantly. We see the sodusting not only for farm program benefits, but also for rather lucrative tax benefits as well. So, I think that this bill, in conjunction with the effective targeting techniques—with as effective targeting techniques as we could devise—would approach that problem.

Senator GRASSLEY. All right. I believe that is the last question I have for you. I appreciate your participation and, hopefully, because this is a new concept, at least as we have written the specifics of it, we would look to you for advice as we continue to work on this legislation.

Mr. MILLER. Thank you, Senator.

Senator GRASSLEY. Our next witness is Clarence Durban with the National Association of Conservation Districts. He is currently the vice president of that organization. Before moving to Washington, he was a grain farmer in Ohio, raising wheat, corn, and soybeans, and obviously you still are. Is that right?

Mr. DURBAN. That is right, Senator.

Senator GRASSLEY. He is also past president of the Ohio Federation of Soil Conservation, and a former supervisor of the Union County Soil and Water Conservation District.

We welcome you, particularly because people in your capacity and your interest play a very major role, at least in my legislation, but as farmers generally look to your organization for technical leadership in establishing this as a very integral part. We want to bring you in, as we have, in our legislation so that we see that only those things that meet the technical goals that we are trying to accomplish are finally approved and then eligible for the tax credit. That is theory behind that portion of our legislation.

I would ask you to proceed as I have stated before.

STATEMENT OF CLARENCE DURBAN, VICE PRESIDENT, NATIONAL ASSOCIATION OF CONSERVATION DISTRICTS, WASHINGTON, DC

Mr. DURBAN. Thank you, Mr. Chairman. Before I do proceed, I would just like to clarify one thing, and that is that I am still a resident of the State of Ohio. I do not live in Washington, DC. We do have an office here.

It is a privilege for me to be here and to testify today on this legislation that we have before us. Let me say at the beginning that the National Association favors investment tax credits for farmers—for those farmers who are willing to make those investments in soil and water conservation expenditures, and in that light, of course, we support both the proposals that are before us today, S. 152 and S. 2180. I would hasten to add, however, that I—nor we as an association—are certainly not tax experts, and I don't know what effect our suggestions may have on the Tax Code, but that is for someone else to address. Our policy, in particular, states that we seek legislation to provide for some or all of the costs for qualified soil and water conservation practices applied to the land by owners and operators of agricultural enterprises such as you have referred to in your remarks in regard to these bills. We feel that much care needs to be taken, that those investment tax credits do not encourage someone to plow marginal lands, that don't have the physical capabilities to withstand cropping I think that some of the incentives that we have had in the past—insofar as accelerated tax write-offs have been concerned—insofar as some systems—production investments and so forth—has caused the land values to increase and have invited this kind of abuse of the land. Marginal land investments is a serious problem today. It is not only in the west—it is a serious problem in the State of Ohio. Sodbuster legislation is a western term. We are as concerned with those types of activities in the State of Ohio as they may be in Colorado and recognize that, as a farmer, it will affect the procedures that I might follow on my own land, and I guess I would say that in southeastern Ohio they wouldn't call it sodbuster—they simply call that plowing around the gully that existed. But the results are the same—erosion of a highly marginal agricultural land.

There has been—in regard to that—the S. 663, which is the sodbuster legislation and addresses some of those problems. We have taken some language directly from that and attached that as an at-

tachment to our testimony, some suggestions that might be added to this legislation that may be of value to prevent those kinds of problems in the future insofar as plowed marginal lands are concerned.

If these suggestions that we make—as an attachment—are used, we feel they would be highly effective in that situation: It has been a privilege for me to appear here today, and I will attempt to answer any questions, Mr. Chairman.

[Mr. Durban's prepared statement follows:]



Testimony of
the
NATIONAL ASSOCIATION OF CONSERVATION DISTRICTS
before the
Subcommittee on Energy and Agricultural Taxation
and
Oversight of the Internal Revenue Service
Senate Committee on Finance

by
Clarence Durban
Vice President

March 5, 1984

on the subject of:

Investment Tax Credits for
Soil and Water Conservation

Mr. Chairman. Members of the Committee

I am Clarence Durban, of Plain City, Ohio, appearing before you today as the Vice President of the National Association of Conservation Districts. It is a privilege for me to bring you the views of our organization today on the important topic at hand.

Let me say at the outset that our association favors the creation of investment tax credits for farmers who are willing to make soil and water conservation expenditures. In this light, we are in favor of the concepts proposed by S. 152 and S. 2180. Let me hasten to add, however, that we are not tax code experts, and have not studied the implications of each of these bills as they would amend the tax code.

Tax policies have an important, though often unintended, effect upon the way in which land is used and treated. This gives us opportunities to greatly encourage the voluntary conservation and protection of land resources through the application of the tax code in ways that encourage such wise use.

National Association of Conservation Districts
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NACD policy states the following:

"Legislation to provide for some or all of the cost of qualified soil and water conservation practices applied to the land by the owner or operator of an agricultural enterprise to be applied as a credit against Federal income tax due in the year the conservation cost is paid, or in succeeding tax years if the conservation credit in the year paid is greater than the income tax due that year."

In applying the credits proposed by S. 152 or S.2180, however, we feel care needs to be exercised so as not to attract investment in lands that do not have the capability to withstand continuous cropping. This has been a serious problem in recent years, as both farmers and speculators have plowed out lands that should have remained in grass or trees, with a large part of the economic incentive coming from opportunity to take advantage of tax benefits. This has been caused both by the availability of accelerated cost recovery on production investments, as well as capital gains treatment on increased land values.

These kinds of investments on marginal lands have created serious problems for agriculture today. They have increased production when the market was already overloaded. They have brought highly erodible lands into production when the nation was becoming more concerned with soil erosion and water pollution. They have created farms doomed to financial failure because the soils are not capable of supporting intensive production.

Therefore, we feel that there needs to be a land quality factor in any new incentive program for conservation or agricultural production investments. Such a quality factor exists, in the Land Capability Classification System administered by the Soil Conservation Service in the Department of Agriculture.

The Senate has already enacted S. 663, which would make certain lands ineligible for USDA farm program benefits if they are converted from other uses to cropland. What this law basically says is that farmers are free to convert any land to cropland that they want, but the federal government will only help underwrite that conversion on lands that have the physical capability to support such a use. We feel that a similar provision would be appropriate in the bills before you today. We have taken language directly from S. 663 and proposed amendments to both S. 152 and S2180. We urge you to consider them.

Mr. Chairman, we appreciate the chance to appear before you today with our views. We commend the Senators from Iowa, as well as the other sponsors of S. 2180, for addressing an important issue. If we can limit these tax incentives to those lands upon which continuous, profitable agriculture is feasible, we will direct new and needed investment into America's farmland base. If you adopt our suggestion, these incentives will not be used to bring the wrong lands into production, and that, too, is vital in the interests of the Nation's farmers.

ATTACHMENT TO NACD TESTIMONY

Proposed Amendment to S. 152 and S. 2180 to limit application of investment tax credits to those investments made on lands that have the physical capability to withstand intensive cultivation.

1. Definitions

The term "agricultural commodity" means any agricultural product planted and produced by annual tilling of the soil, including one-trip planters.

The term "highly erodible land" means land classified by the Soil Conservation Service of the Department of Agriculture as class IVe, VIe, VII, or VIII land under the land capability classification system in effect on the date of enactment of this Act. The land capability class for a field shall be that determined by the Secretary to be the predominant class under regulations issued by the Secretary.

2. Prohibition

A. In S. 2180, add a new subsection (3)(D) at line 23, page 7, as follows:

"(D) not classified as highly erodible land, unless the taxpayer:

(a) certifies that the land will not be used to produce an agricultural commodity as defined in this Code, or

(b) provides a certificate issued by the local conservation district which certifies that the taxpayer has installed and is maintaining an adequate soil and water conservation system on the land.

B. In S. 152, add the new definition and a new subsection 3.(c) as follows:

(c) A new section ____ is added to Section ____ of such Code as follows:

() Taxpayers claiming such credits as allowed under Section ____ of this Code will be required to provide certification that:

(A) the land upon which the expenditures were made is not being used for the production of agricultural commodities as defined in this code; or

(B) the land upon which the expenditures were made is not defined as highly erodible land by the Soil Conservation Service; or,

(C) a conservation system meeting the standards of the local conservation district has been installed on the land and is being maintained in approved condition.

Senator GRASSLEY. Let me say that we are running a little bit ahead of time, so if you have a couple more points you would like to make, you are free to do it.

Mr. DURBAN. Only in the terms of the attachment, Mr. Chairman, that state specifically the one paragraph that I would read:

"Highly erodable land" means land classified by the Soil Conservation Service of the Department of Agriculture as Class IVe, VIe, VII, or VIII land under the land capability land classification system which they have in effect.

The land capability class for a field shall be that determined by the Secretary to be the predominant class under regulations issued by the Secretary.

We also believe that taxpayers claiming credits under such a section would be required to certify that the land upon which the expenditures were made is not being used for the production of agricultural commodities as defined in this code or the land upon which the expenditures were made is not defined as highly erodable land by the Soil Conservation Service, and that the conservation system meeting the standards of the local conservation district has been installed on the land and is being maintained. We stress the word maintained in the above condition.

I think that, in our way of thinking, would enhance this program and thereby help to eliminate the problem that sodbuster is attempting to do.

Senator GRASSLEY. You might be interested in knowing that in my State, evidently because of State programs that exist, personnel of the Soil Conservation Service are going around from farm to farm—because they came to mine within the last week or so—and giving a certain number of years—I think 2 or 3 years—to submit a plan. Now, that plan does not have to be followed, but if you hope to benefit from either the State soil conservation program where the State money can go to individual farmers for land improvement, or if you want to participate in the young farmers' home ownership program, or in another program that permits the use of State loans for the purchase of minimum tillage equipment so that you can use minimum tillage from programs, that you won't qualify for those programs unless you have certified that you are going to follow such a program. And I assume that, from your last comment, your suggestion in regard to highly erodable land would follow that same premise?

Mr. DURBAN. Yes.

Senator GRASSLEY. For Federal funding?

Mr. DURBAN. Yes.

Senator GRASSLEY. Or for the use of the tax credit?

Mr. DURBAN. Or for the use of the tax incentive. Yes.

Senator GRASSLEY. Let me ask you this. Does your State of Ohio have any of these requirements that we talked about from my State, or that you are talking about for the Federal Government yet?

Mr. DURBAN. No, Mr. Chairman, we do not in the State of Ohio. We have a pollution abatement program that was not funded by the State of Ohio. Therefore, the legislation stated that unless funding was available on a cost-share basis at the State level, that we could not enforce that, and it has not been made available to us from that standpoint.

We had then desired to go from that program into one with soil erosion problems, but we are taking one step at a time, and until we achieve the first, we will not be able to deal with the latter.

Senator GRASSLEY. Remembering my years in the State legislature, I think we started out that same way. First of all, we passed a program, and then it was probably 5 or 6 years later—now 10 years back—that we did actually put some money into it. Still though, as I recall, there is a reluctance on the parts of the courts to enforce it—one neighbor against another is really pretty much how it has had to work. I mean, say one neighbor filing a complaint against another neighbor, and that is not necessarily the easiest way to enforce the sort of abatement law that you are talking about.

Mr. DURBAN. No, no, Senator, I agree with you—it is not. Our philosophy was—at that time I served as the president of the Ohio Federation—that if the problem were there and the local conservation district board had an opportunity to talk to that neighbor, that some of those problems could be resolved and, in fact, that has happened even without cost-share moneys in the State of Ohio on many of those lukewater pollution abatement programs insofar as the dairymen or a feed lot or something like that was concerned—simply talking on a voluntary basis.

There are, however, some farmers that couldn't afford to do that, so we had to pass those situations.

Senator GRASSLEY. To establish a record for the purpose of the legislation, I want to ask you a question that probably the answer is very obvious, particularly somebody coming from your background of soil conservation. I need to have you in a short, general statement establish the seriousness of the soil erosion problem and, in conjunction with that, the importance of Congress to appropriate money and enact tax incentives to address the problem.

Mr. DURBAN. Mr. Chairman, the seriousness of the erosion problem to a farmer is somewhat difficult to assess because of the fact that we have managed to maintain production through the use of increased fertilizer. Our costs have skyrocketed—we hear that every day—but a lot of that, we know, is the result of erosion problems. Just how long technology can continue to make the difference between the loss of topsoil and water—the water goes as fast as that topsoil, so we are losing water—so thereby we are creating two problems—but just how long technology can continue to keep that production level where it is is questionable. As farmers, it is imperative that, at this point, there be some kind of an assistance, and I am not suggesting a direct payment, but a tax incentive for the man who wants to do the kind of a job that needs to be done. And I believe that those people—and there are some farmers that are making a little money—there are some who are going broke—that there are a few who are still paying some income tax. I believe they will take advantage of that. There is simply not enough dollars—even for those who are making the money—to put those long-term costly conservation practices on the land. Certainly, a tax incentive would assist that. The fact that there might be some passive investors that have been mentioned turned off—I simply don't buy that concept because I don't think the passive investor is that concerned with the conservation of the soil or the water. He never has been. That has always been the problem of the Soil Conserva-

tion district for the person who invested his money and lived many miles away—or 2 miles away—it didn't matter. So, I don't think he will do any more or less with a tax incentive on that kind of land. But certainly, the bona fide farmer will do more. I am convinced of that.

Senator GRASSLEY. Assuming that somewhere technology reaches a point of diminishing returns—or at least less returns—what are the consequences if we do nothing with soil conservation problems?

Mr. DURBAN. I guess, Senator, if we do nothing, all we need do is look at some of the ancient civilizations of Asia and some of those countries and realize that they are gone. And the deserts that used to produce abundance, there is nothing there. From my standpoint, that is what I can see. I don't see it happening tomorrow or next week, but I think that is the alternative.

Senator GRASSLEY. We have already established the point that my bill gives regulatory authority to add new soil conservation technologies as new advances are made so that they can do that to the long list that is in the bill. Will this give Soil Conservation Services enough flexibility to add new practices?

Mr. DURBAN. Yes, I think it would. I see no problem with that. The big practice that we are doing now that is doing a great amount of good—as was mentioned by the Senator a moment ago—is minimum or no tillage, which does not require all that much technical assistance. It needs some—there is no question about that. But certainly, that equipment is costly. If there still is investment tax credit on equipment, that is certainly a feature that we need to see continue which has nothing to do with this bill, and I recognize that. But it is an issue with agriculture that those things are maintained.

Senator GRASSLEY. I see. Again, to emphasize that we have the Soil Conservation Service providing certification, for the qualifications of certain programs of the tax credit, I hope there is no doubt in your mind that SCS has sufficient expertise to certify programs?

Mr. DURBAN. Yes, the expertise is there.

Senator GRASSLEY. OK. And I don't think that there is any doubt in anybody's mind about the reputed professionalism and scientific approach to soil and water conservation that the Agency has behind it.

Mr. DURBAN. None whatsoever.

Senator GRASSLEY. OK. Do you have any advice to Congress beyond what the soil conservation credit approach tries to accomplish? Is there anything Congress can do to address the serious problem we have before us on soil conservation?

Mr. DURBAN. No, Senator, I guess at this point I wouldn't. There are many things that we see need to be done, but there is always somebody who is asking for additional dollars or somebody asking to help me do this or do that. We recognize, as farmers, that we have a problem with budgets and those kinds of issues that you do—we recognize that. We are not here asking for large handouts and don't expect it and don't want it to happen. If there were just the very incentive program that you are referring to, we have talked about this for some years—that kind of a situation where a person who was willing to do something could be rewarded for it—not paying somebody to do something that he maybe didn't want to

do in the first place and only did it because he was getting a check. We believe this particular legislation gives him the opportunity to do something he wants to do because he can afford to because he is going to have a little return from it, at least, but he is going to need to want to do it or he isn't going to do it anyhow.

Senator GRASSLEY. OK. I thank you very much, but I also urge you as well as your organization to keep in touch with us. As you study this legislation to a greater extent, as time lapses, and if it hasn't passed, please come forward with us because we are striking out new territory to some extent. We have already sought the advice of your people—both in my State and in the national organizations—but we would encourage you to continue the dialog.

Mr. DURBAN. Thank you, Senator.

Senator GRASSLEY. Thank you very much. I now have the privilege of inviting Bob Gray, director of policy development of the American Farmland Trust to speak. From 1979 to 1981, Mr. Gray was the executive director of the national agricultural land study, a major Federal interagency task force, culminating in a report to the President. As director of policy development, Mr. Gray provides technical assistance to State and local governments on the design and implementation of soil and water conservation programs. I could also say, for the benefit of others here who may not know you, that I have had the privilege of working with you when I was a member of the House of Representatives, as you worked closely on legislation—some of it controversial and some of it not so controversial—as I recall. And we look forward to your testimony, but also to your continued dialog with us on this subject.

STATEMENT OF ROBERT J. GRAY, DIRECTOR OF POLICY DEVELOPMENT, AMERICAN FARMLAND TRUST, WASHINGTON, DC

Mr. GRAY. Thank you very much, Mr. Chairman. I appreciate those kind words. I do appreciate the opportunity to testify today on these pieces of legislation. I think they are very important, and as you may know, the American Farmland Trust is a small organization—a private, nonprofit organization—and we have only been in existence about a little over 3 years now. We have 27,000 members nationwide, including a lot of farmers and ranchers who belong to our organization, since we do work in both the areas of farmland protection and soil conservation.

About 2 years ago, we undertook a rather extensive look and analysis of the Nation's soil and water conservation programs—specifically the soil conservation programs—and part of that whole effort involved interviewing 700 farmers in six different States on soil conservation—finding out what they were doing in soil conservation, finding out what they thought about various policy aspects of soil conservation. One of the questions we asked them involved the issue of tax credits and, in fact, we interviewed in your State in Warren and Marion Counties 125 farmers—in those two counties—and one of the question we asked them in the policy area was how they stood on tax credits. And we found that generally—across the board—there was very strong support for this among the farming community. In fact, it averaged 79 percent of the farmers—the 700 farmers—whom we talked to in those six States who supported

some kind of a tax credit as an incentive to encourage greater soil conservation. Only 14 percent—a little over 14 percent—of the farmers opposed it, so it had rather unanimous strong support across the board. As a matter of fact, in Warren and Marion Counties, the average was about the same as the total average—it was 79.2 percent.

Senator GRASSLEY. What year was this study?

Mr. GRAY. This was done in the fall and winter of 1982-83.

Senator GRASSLEY. So, it is very recent?

Mr. GRAY. Very recent. Yes, sir. And we spent over an hour with each individual farmer asking them several questions, and we hired people at the local level to do this—retired farmers, housewives, other people who were available in the community. So, we went in those communities, working with SCS and ASCS, to obtain the farmer lists, and then we went out and interviewed them. It took in some cases almost 2 months to reach all of these farmers, but we found an awful lot of material from that. And we have made a series of recommendations in a report—in fact, I have testified a number of times on both the House and the Senate sides on soil conservation—and we have a series of policy recommendations. On the 21st of March, we plan to officially release our report, which includes 24 separate recommendations. Now, I would just like to touch briefly on the question of tax incentives. I am not a tax expert—I don't claim to be—I am not that familiar with the various provisions of the Tax Code, but we did not make any specific recommendations in our report on tax credits—using them as an incentive for soil conservation—mainly because it was difficult for us, No. one, to get the kind of information we needed as to how effective they were. It was very difficult to pull that information together. We found that, in many cases, they only appealed to a fairly broad sector of the farmers since it would only deal with those farmers in the higher income tax brackets. But I think the question is what kind of practices were being used, whether those practices were going on land that was highly erodable that could reduce erosion—these were the considerations that sort of led us to believe that it was difficult for us to come up with a very specific recommendation.

I would like to add that we had three—

Senator GRASSLEY. You are talking about a specific recommendation on a specific type of tax credit or whether the tax credits ought to be used at all?

Mr. GRAY. I think in both cases. As I finish my testimony here, I think the tax credits do have a place, but I guess the issue is the specific kind of tax credit that would really start to do the job. So, as we looked at it, we had three technical papers completed—in fact, one by an economist at the University of Iowa, and two attorneys who were experts in the tax field, and particularly one who had worked with farmers—and their results in their papers were sort of inconclusive. So, it is a little bit frustrating to deal with this because, you know, it sounds good, farmers support it, but it was difficult to come up with a very specific proposal as far as we were concerned. I think the two bills here today—and I specifically think your bill has a lot of good points in it—and I would just like to conclude my testimony by saying a couple of things. One is that

I feel that in order to be effective, tax credits have to be part of a total package—it can't be done separately because they only cut through a fairly small segment where they would be used in the farming sector. Second, I think it is important—and I would like to echo what Clarence Durban pointed out in his testimony—that the kind of availability of the provisions of this bill should be tied somewhat to some of the legislation that is pending.

What I mean specifically is that the sodbuster bill—where we have the definition of highly erodable land—some of that land that is so eroded that it is really impossible with the technology that we have today to get good conservation practices—I don't think people should be allowed to have tax credits to be encouraged to bring that land into production. And I would also say that a lot of that land is not just within the Great Plains, even though it sounds that way from the sodbuster bill. For example, a chart here that I brought in showing different States where the erosion is concentrated—in Iowa, for example, on just 11 percent of the agricultural land in that State, there is about 55 percent of the erosion which occurs on a fairly small percentage. So, we have brought in—even in an intensively cultivated State like Iowa—some pastural land and marginal land that has contributed to erosion. We should not encourage that any more through a tax credit proposal, but I think this has some good aspects to it. I would encourage you to pursue it, but as I said, I think it should be part of a total package, including the provisions of the sodbuster bill. I hope that the House will pass them. Senator Jepsen has been very strongly supportive of the conservation reserve idea that we have put out in our report, and that is, when you have a set aside program, give farmers the opportunity to bid out some of that highly erodable land that has been brought in as cropland, get it out for a 7 to a 15 year basis—get it back into grass and trees.

We found in our research, for example, Senator, that just 12.5 million acres of that highly erodable land—if we could retire that—we would reduce erosion by one-third in this country. I think those are very significant figures, and I think that that kind of program in combination with some tax incentives as well as these other provisions would, I think, go a long way toward reducing the tremendous soil erosion that we have in this country.

I appreciate the opportunity to appear here today.

[Mr. Gray's prepared statement follows:]



American Farmland Trust

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Testimony
Before the Joint Subcommittee
on
Energy and Agricultural Taxation
and
Oversight of the Internal Revenue Service
of the
Senate Committee on Finance

March 5, 1984

Robert J. Gray
Director of Policy Development
American Farmland Trust

Mr. Chairman, members of the Joint Subcommittee, I appreciate the opportunity to testify today.

The American Farmland Trust is a private, non-profit organization dedicated to seeking solutions to conserving our soil, protecting our nation's agricultural land base and promoting farming opportunities. In response to requests from public officials, farm organizations, farmers, ranchers and citizens' groups, AFT helps to formulate public policies that encourage farmland conservation; to enable farmers to earn a respectable return on the equity in their property without liquidating it. AFT devises innovative conservation alternatives on a case by case basis. And to increase public awareness of both the importance of conserving our agricultural land resources, and the "middleground" approaches that are available to achieve this goal, AFT conducts research, sponsors conferences and publishes educational material.

The basis for AFT's support in these various endeavors are the 27,000 individuals, representing every state in the nation, who belong to our organization. We are proud of what we have accomplished in the relatively short time AFT has been in existence.

Since the Joint Committee is considering two bills, S. 2180 and S. 152 dealing with tax credits for expenditures on soil or water conservation, I would like to relate to you some of the findings AFT has set forth as part of a recent analysis of the national soil conservation programs.

In addition to the analytical and technical work undertaken by AFT as part of this extensive project, one of the key elements was to find out what farmers and ranchers were doing -- about soil conservation. Therefore, we undertook a series of extensive interviews with approximately 700 farmers and ranchers, including owners and operators, in six separate states.

Each interview took over one hour to conduct. The farm owners and operators were asked to assess the efforts of public agencies to control erosion on agricultural land; to reveal what conservation practices they were using; and to describe how they felt about different public policies and programs that might be used to further soil conservation.

Table 1 (attached) illustrates how strongly the farmers and ranchers in these six states supported the idea of tax credits.

However, although there seems to be strong support in the farming community for tax credits on soil conservation expenditures the question remains as to their overall effectiveness as a public policy tool. Since I am not that well acquainted with the various provisions of the internal revenue code, I would like to offer my views on tax incentives, in general, as they apply to improving soil conservation efforts among farmers and ranchers.

Table I

FARMERS ATTITUDES TOWARD SELECTED SOIL CONSERVATION POLICY ISSUES
 PERCENTAGE PER RESPONSE CATEGORY

	Washington (Colorado)	Warren/Marion (Iowa)	Haywood (Tennessee)	Grant (Wisconsin)	Jackson (Illinois)	Perry (Missouri)	Average
<u>Policy Positions</u>							
Farmers who invest in soil conserva- tion should be given credits on their income tax							
"Strongly Agree" & "Agree"	60.9	79.2	97.2	78.3	80.4	78.1	79.0
"Undecided"	9.6	8.0	0.9	3.5	8.8	9.6	6.7
"Disagree" & "Strongly dis- agree"	29.6	12.8	1.9	18.2	10.8	12.3	14.3
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
N =	(125)	(125)	(108)	(143)	(102)	(73)	(6)

Tax incentives are tricky instruments for achieving public policy objectives - for several reasons. First, regardless of the laudable public purposes proclaimed by their advocates as reasons for enacting them, they indisputably achieve at least one result: they reduce the taxes of a specific group of taxpayers. Thus, there is an essential ambivalence about their fundamental aim that penetrates to their essence: were they enacted to achieve the nobler goals, the crasser goals, or (most probably) both?

Second, they are economic incentives that are most attractive to taxpayers in the higher brackets. Thus, they will not influence the behavior of those who pay little or none of the tax involved, and they are generally regressive in their impact. Also, most of the decisions they seek to affect are made for a variety of reasons, only a few of which are purely economic in nature. Non-tax considerations, therefore, often overwhelm tax considerations so that the tax incentives cannot sway the decisionmakers in the desired direction.

Third, it is difficult to measure their effectiveness. For instance, in evaluating the effectiveness of tax incentives for reducing soil loss due to erosion, one would have to know, first, the total number of decisions to invest in soil conservation facilities that were made only because of the availability of the tax incentives. Those that would have been made regardless cannot be included in the overall calculus. Second, one would have to know the present value of the reductions in soil loss attributable to actions induced by the incentive over a reasonable time horizon - a value that is conceptually and factually difficult to derive. Third, one would have to estimate the present value of total lost revenue attributable both directly and derivatively to the tax incentive. The data needed for these calculations are often either not available or by reason of the fact that they entail predictions of future events, not calculable with any degree of confidence. Only by comparing the second and third values above can one determine the effectiveness and efficiency of the incentive.

Fourth, tax incentives are designed to attract capital that would otherwise be invested elsewhere. The consequences of this shift are, first, that prices will be bid up in the targetted sector because after-tax profits are higher, second, the allocation of capital among different portfolios will be distorted by tax considerations and may not conform to a pattern that is economically most sound (this fact was recognized by Congress in 1982 when, in the Tax Equity and Fiscal Responsibility Act, it gave the IRS increased power to challenge business arrangements that had little economic justification but which taxpayers entered into solely for the tax shelters they provided), and third, the composition and values of the new investors will differ from those of the old, with consequences that may be undesirable. In agriculture, for instance, they will be less likely to share the work and land ethics of farmers, and more likely to be guided primarily by considerations of profitability.

Fifth, tax incentives work rather broadly, and "in the abstract," so to speak, unless they are conditioned quite rigorously so as to promote specific policy objectives. Thus, in the area of soil conservation, it is unlikely that there is a natural congruence between the owners of land that is suffering the worst erosion and the taxpayers who would avail themselves of soil conservation tax incentives. As a result, some of the tax savings will go to owners of land that is not eroding at a high rate and will in a real sense be "wasted."

Sixth, tax incentive provisions complicate tax laws and reduce their neutrality. Once installed, they escape the annual legislative scrutiny that ordinary expenditure proposals receive by committees that possess significant amounts of knowledge and understanding about a fairly broad field of governmental concern.

Seventh, tax incentives operate on investor decisionmaking in a world that is subject broadly to an overriding law of supply and demand. If they increase after-tax income in one sector of the economy, or for one class of assets such as farmland, demand in the section will increase relative to others, and price will rise until a new equilibrium is reached. As a result, (subject to differences in elasticity of supply already noted) the net after-tax return will approach preexisting levels and the tax incentive will lose most or all of the power to influence investor behavior. The principal beneficiaries will be those who owned the good before the institution of the tax benefit and were able to hold it until after it reached its new higher value based on the capitalization of higher after-tax profits.

Eight, tax incentives are often easier to enact than programs involving outright expenditures of funds. Thus, if they promote a legitimate public purpose, they may be the only feasible means for doing so. They involve less bureaucracy and "regulatory friction" and therefore less government interference with private decisionmaking than do, say, regulatory approaches. They exist, and people may take advantage of them or not, depending on how they evaluate them. Incentives often enjoy a greater stability than programs employing expenditures that must be re-approved each year, and therefore permit private investors to plan and act with greater confidence. The legal, accounting, and investment advisory professions are well-equipped to bring their existence to the attention of clients and investors.

On balance, then, tax incentives have both strong points and weak points, and the challenge is to shape a package that effectively maximizes the first set of considerations and minimizes the second. With respect to tax incentives for soil conservation, the general lesson we can learn from the relatively few programs now in existence is that tax incentives can play a sound and legitimate role in a comprehensive program for the reduction of soil erosion if they are conditioned in ways that assure they will induce corrective action where it is needed most. Thus, tax incentives for soil conservation must be treated as a constituent element of an

overall program for control of soil erosion, not simply one benefit to be made available by itself. Such a program must be shaped with an understanding of the major factors that cause soil erosion, such as bringing new, highly erodible land into production. In this particular vein, I would strongly urge the Joint Subcommittee to consider tying this kind of legislation to the "sodbuster" bill which recently passed the Senate. Specifically, individuals who would be eligible to use the provisions of either S. 152 or S. 2180 should not be allowed conservation tax credits on "highly erodible land" as defined in the "sodbuster" bill. This would ensure compatibility between these various pieces of legislation.

In summary, AFT did not specifically recommend conservation tax credits as one of its 24 recommendations soon to be released. Our reasons can be traced to some of the shortcomings of this type of approach that I have laid out in my testimony.

However, I do feel that soil conservation tax credits could encourage increased soil conservation efforts and therefore should be given serious consideration. If they are included as part of a total conservation effort including (1) the sodbuster legislation (2) establishment of conservation reserve (3) targetting of cost-sharing and technical assistance and (4) a federal farmland protection policy -- they can provide an important piece to the total package.

I appreciate the opportunity to testify and will be glad to answer any additional questions.

Senator GRASSLEY. In regard to sodbustering, wherever it is—in Iowa or Colorado—have you studied the legislation enough to feel that the precautions we have taken will stop its use in those areas?

Mr. GRAY. In your specific bill, Senator?

Senator GRASSLEY. Yes.

Mr. GRAY. No; to tell you the truth, I am not sure. I think it would be good in the bill to amend it possibly to include the definitions of highly erodable land used in sodbuster bill.

Senator GRASSLEY. But that is all it would take, just a definition then?

Mr. GRAY. I think it would. I think that would be good because you have the provision by SCS—that has been one of the problems in the past in any tax incentive that they were not in the loop, and how did you know it was a certified practice and how did you know it was going on land where there was going to be a reduction in soil erosion, because we found, for example, in our analysis that terraces and other conservation practices in the past sometimes had been put on land that was not that erosive and that we have not been targetting some of our most erosive land—not the highly erodable land in the sodbuster—but land that is eroding at a fairly high rate where we would have a loss of productivity.

Senator GRASSLEY. What is your view on trying to exclude the passive investor in the use of the tax credit? In other words, we have it limited to those people who are involved in the occupation of farming—that is not the real tax term, but anyway, the occupation of farming—people who have a material interest in it and

some risk, I guess, would be the deciding point there—for them to qualify for this. Suppose a person who is just a passive investor?

Mr. GRAY. I tend to feel that people who have invested in the land should also be given an opportunity even though they are not materially involved in the management, I guess, or whatever the term is of the farming operation. I would tend to go further and make them eligible for it as well because we are seeing a lot of investment in land, and we saw that the farmers that we interviewed were renting over half of the land they were operating.

So, these are people out there investing in land and people we are going to have to deal with as part of these conservation programs.

Senator GRASSLEY. Right or wrong, I guess we thought that part of the problem with the encouragement for sodbusting came from those people who just were passive investors, didn't have a long-term interest in the land, were looking at it either for speculation or for tax advantages, and that that is where the problem came. So, we felt that that was one way of curbing the abuse of the land, at least in that narrow area.

Mr. GRAY. That is a good point. There is no question that in some cases people who have invested in land without any long-term commitment have been the most guilty of some of the lack of conservation practices.

Senator GRASSLEY. Do you think we are too narrow in our approach by having SCS certify every practice for qualification for the tax credit?

Mr. GRAY. No; I think that is a good idea. I really do because then it would legitimize it from the standpoint of whether or not that was a practice that was on the right land that was eroding and that it was the kind of practice that would result in reducing erosion.

Senator GRASSLEY. I don't know for sure whether your organization—the Farmland Trust—has an interest or not in water conservation, but you know our legislation deals with that.

Mr. GRAY. Right.

Senator GRASSLEY. Do you have an interest in that area, and if so, then, do you have any comments on that aspect of our legislation?

Mr. GRAY. We do have interest in that area, Senator.

Generally, I think that part of the bill is good, but I have not studied that aspect of it. We have not done that much work recently in the water conservation area. We are concerned about it, but we have not completed any analysis of that. That is probably an area we will be moving into next.

Senator GRASSLEY. You don't have any reluctance to accept the judgment of the Soil Conservation Service in regard to all of these decisions?

Mr. GRAY. No, sir.

Senator GRASSLEY. We also give the Soil Conservation Service authority, through regulation in future years, to add to the list or to change the list of soil conservation. Does that cause you any problems?

Mr. GRAY. No; as new technology comes through, they should have the opportunity to do that.

Senator GRASSLEY. I believe we have addressed all the concerns that I had. I want to thank you very much. And again, I have known you to get in very deep in these areas from the relationship that I had with you in the House of Representatives, and I don't know to what extent we have consulted you specifically on this, but don't be reluctant to take the initiative to come to us.

Mr. GRAY. OK, thank you. I appreciate that very much.

Senator GRASSLEY. And I would appreciate that very much.

Mr. GRAY. Thank you very much, Senator.

Senator GRASSLEY. Our hearing is just about over. There is one other matter. The Farm Bureau Federation has submitted a statement to be included in the record. I would like to make note of that, and it will be included at this point in the record.

I want to thank the American Farm Bureau Federation and John Datt, who signed the letter. He is secretary and director of the Washington office. Grace Allen Rice is also in the audience, here to monitor the hearing. I appreciate that very much.

I want to say also that I am disappointed that neither the Department of Agriculture nor the Treasury Department responded to my invitation to come and testify. I am disappointed because I would think that they would consider soil erosion problems to be a major national concern and that they ought to come and express the views of the administration on that, and if it is a matter of time as far as I know, we have enough bureaucrats in both the USDA and the Treasury Department that surely they could have found somebody at some level to come up here and at least show a little bit of interest in regard to this matter. I am disappointed. I will have to discuss that with them privately, but I don't think it speaks very highly of an administration that ought to be concerned about soil conservation, and I am sure they would say that they are.

I want to thank all of the panels—all of the witnesses—all the people who came to listen, and to say that even though they were not invited to testify, if there is any person or group that wants to submit a statement of concern on this issue, assuming it is not too voluminous—that it is too expensive to print—that it will be included in the record as a matter of course, and the hearing record will be open for 15 days to receive either that testimony or any corrections, additions to any testimony already given.

The meeting is adjourned.

[Whereupon, at 3:16 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

For Immediate Release
Apr'l 10, 1984

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
AND THE
SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE
OF THE SENATE FINANCE COMMITTEE

Messrs. Chairmen and Members of the Subcommittees:

I appreciate the opportunity to submit for the record the Treasury Department's views on S. 152 and S. 2180, which would provide investment tax credits for soil and water conservation expenditures and equipment. The Treasury Department opposes both of these bills.

Background

Existing law (Code section 175) permits a farmer to deduct currently, rather than capitalize, soil and water conservation expenditures and expenditures for the prevention of soil erosion. Such expenditures include the treatment or movement of earth, such as leveling, grading and terracing, contour furrowing, construction of channels, ditches, dams and ponds, eradication of brush and planting of windbreaks. Similarly, section 180 permits farmers to deduct capital expenditures for certain fertilizer, limestone and other materials to enrich or condition the land; and section 182 permits the expensing, within certain dollar limits, of capital expenditures for clearing land for farming.

All of the farming expenditures covered by sections 175, 180 and 182 normally would be capitalized and added to the farmer's basis in his land. Because land is not depreciable, these costs could be used only in determining gain or loss when

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the land is sold. In 1954, Congress determined to permit immediate expensing, at the election of the taxpayer, in lieu of capitalization. The rationale of the expensing provisions is straightforward -- in the case of farming, it would be very difficult and burdensome for the taxpayer, as well as for the Internal Revenue Service, to distinguish between deductible land expenditures, such as ordinary tilling and fertilizing of the soil, from properly capitalized expenditures, covering the costs of grading, terracing, land clearing, and certain fertilization materials. A farmer's labor is continually and constantly expended on one aspect or another of maintaining his land. Segregating and keeping accurate records of ordinary expenses and repairs versus capital expenditures would be a difficult task.

The Treasury Department believes existing law generally constitutes good tax policy in this regard. The bills before us today, however, would move in a very different direction. These bills would significantly complicate, rather than simplify, tax policy towards farmers.

S. 152 and S. 2180

S. 152 would make certain expenditures for soil and water conservation for farmland eligible for the regular 10-percent investment credit. Amounts eligible for the investment credit would include soil and water conservation expenditures within the meaning of section 175(c) that the taxpayer does not elect to expense under section 175. The bill would apply to soil and water conservation expenditures made in taxable years beginning after December 31, 1982.

S. 2180 would apply a 20 percent investment credit to a broader range of soil and water conservation expenses and equipment, as well as to assessments paid to soil and water conservation districts. The amount of the credit would be limited to 100 percent of the taxpayer's tax liability for the year up to \$25,000, plus 85 percent of any tax liability exceeding \$25,000. In addition, the amount of credit attributable to non-irrigation property would be limited to 25 percent of the taxpayer's gross income for the year derived from farming. Finally, the credit for soil and water conservation property would be proportionately denied to the extent that the property was financed by a tax-free government grant.

Property eligible for this 20 percent investment credit would include a wide range of irrigation systems and capitalized soil and water conservation improvements. To qualify for the credit, any irrigation and conservation improvements must be used in connection with United States farmland owned by U.S. citizens, and must be certified by the Soil and Water Conservation Commission both as being consistent with state-of-the-art irrigation and conservation practices, and as making a "major contribution" to soil and water conservation. No deductions would be allowed under sections 175, 180 or 182 for property

taken into account in determining the credit. The taxpayer would be limited to straight line depreciation on any irrigation property used in determining the credit. The credit would apply to irrigation or conservation property constructed, reconstructed or placed in service in taxable years beginning after December 31, 1983.

Discussion

The Treasury Department opposes both S. 152 and S. 2180. Contrary to existing law, which virtually eliminates the need to make difficult distinctions between different types of farming expenses, these bills would put a great deal of pressure on farmers and the IRS to distinguish between soil and water conservation expenditures and other farming expenses for purposes of a tax credit. S. 152 would qualify for the investment credit only those soil and water conservation expenses presently defined in section 175(c), as distinguished from fertilizing, land clearing, and any other currently deductible land tilling expenditures. We question, however, whether it would be feasible for either taxpayers or the IRS to make accurate determinations of these different types of costs. In addition to the new accounting burdens, the bill would create significant potential for abuse through attempts by taxpayers to recharacterize all types of/and tilling expenses as soil conservation expenses. We very seriously question whether this is good policy. We also object to the retroactivity of S. 152.

S. 2180 does not adopt the definition of conservation expenditures used in section 175(c), but instead creates an enormously complicated set of new rules allowing a 20 percent credit for specific types of irrigation properties and conservation improvements, provided that these improvements are made to U.S. farmland owned by U.S. citizens, and provided that the improvements are Federally certified as being modern and effective. Complicated limits are set on the amount of the credit, including a rule that would deny part of the credit to the extent that the farmland improved by the conservation expenditures was financed in any part by tax-free government grants. All expenditures not eligible for the credit would continue to be currently deductible. Here again this line-drawing between types of land-tilling expenses would create a significant amount of unnecessary complexity and abuse potential.

Finally, we must seriously question the desirability of any credit for soil conservation. Code sections 175, 180 and 182 already provide significant incentives by permitting immediate and total expensing of capital expenditures for soil conservation. We believe the case has not been made that a Federal tax incentive is needed to encourage farmers to do what is in their own best interest -- *i.e.*, to conserve the soil which is their principal asset and the heart of their livelihood. We therefore do not believe that Federal assistance through the tax law is desirable, particularly in this time of budgetary austerity and substantial excess of farm production capacity.



American Farm Bureau Federation

March 1, 1984

WASHINGTON OFFICE
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Honorable Charles E. Grassley
United State Senate
Washington, D.C. 20510

Dear Senator Grassley:

The American Farm Bureau Federation is pleased to support S. 2180, legislation introduced by yourself to provide a 20 percent investment tax credit for soil and water conservation expenditures. An increased investment tax credit will provide an additional incentive for farmers to prevent the devastating erosion of topsoil.

S. 2180 is consistent with Farm Bureau policy adopted by voting delegates of member State Farm Bureaus at the AFBF annual meeting in January, 1984. Delegates adopted the following policy which places emphasis on the use of cost-sharing through income tax credits for soil and water conservation practices.

Conservation Programs

"We recognize the importance of maintaining a productive soil resource. We believe this can best be accomplished through:

- (1) Voluntary programs using cost-sharing and tax incentives;
- (2) Properly funded educational and research programs;
- (3) Emphasis directed at the most critical erosion problems;
- (4) Strongly urging farmers to keep their soil losses within acceptable limits;
- (5) Making use of present agency personnel to provide technical assistance;
- (6) Programs being directed locally by elected soil conservation commissioners; and
- (7) Committing a greater portion of government expenditures to on-farm conservation efforts.

We support the retention of conservation payment programs operated by locally elected Agricultural Stabilization and Conservation Service (ASCS) farmer county and community committeemen.

We recommend a federal program of cost-sharing through income tax credits for soil and water conservation practices and structures which contribute to enduring conservation and environmental enhancement by reducing the discharge of soil particles.

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Limitations on cost-sharing under the Agricultural Conservation Program (ACP) should be removed for conservation measures required by plans under Section 208 of the Clean Water Act. Greenhouse operations should be included in the ACP provisions.

We favor lengthening the cycle of time required under the Resource Conservation Act for determining approval of conservation efforts.

We recommend the provision of adequate local, state, and federal funds to finance soil mapping and publication of soil survey information.

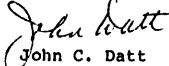
We are in favor of long-term agreements because of their success in getting conservation practices installed and maintained on the farm."

As you pointed out in your floor statement, the increased production that farmers have accomplished within recent years through the use of improved crop varieties and fertilizer will at some point no longer be able to compensate for soil loss. We believe that it is crucial to halt topsoil loss because productive land is the principal asset in a farmer's business operation. Without the preservation of this key capital investment, productivity is certain to decrease. While some states are more affected than others by soil erosion, the problem is national in scope because it determines the ability of farmers to provide food for the domestic market, as well as furnish commodities for the export market.

S. 2180 is an appropriate bill to address this problem by encouraging soil and water conservation. It contains sufficient incentive through a 20 percent investment tax credit to encourage farmers to participate in conservation practices. In addition, it contains safeguards to prevent abuse by permitting use of the credit only for approved soil and water conservation practices as recommended by the Soil Conservation Service. Also, the amount of conservation measures a farmer may claim is limited to 25 percent of a taxpayer's gross income from farming. This is a critical safeguard. In addition, the bill provides relatively simple treatment of depreciable property by limiting depreciation to the straight-line method. The bill's simplicity, safeguards, and incentives make it a desirable way to address the problem of soil erosion.

Farm Bureau is pleased to offer support for S. 2180.

Sincerely,



John C. Datt
Secretary and Director
Washington Office

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