Statement of the
American Farm Bureau Federation

TO THE HOUSE COMMITTEE ON AGRICULTURE

"AGRICULTURE AND TAX REFORM: OPPORTUNITIES FOR RURAL AMERICA"

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Presented By:
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On behalf of the American Farm Bureau Federation

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Chairman Conaway, Ranking Member Peterson and members of the Committee, thank you for scheduling this hearing on Agricultural and Tax Reform: Opportunities for Rural America. It is important for the Committee on Agriculture to shed light on tax provisions important to farmers and ranchers as the 115th Congress begins to rewrite our nation's tax code.

My name is Pat Wolff and I serve as Farm Bureau's tax policy specialist. Farm Bureau is the country's largest general farm organization, with nearly 6 million member families and representing nearly every type of crop and livestock production across all 50 states and Puerto Rico. Farm Bureau appreciates the opportunity to highlight tax code provisions important to the long-term financial success of farm and ranch businesses.

Farms and ranches operate in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncertain weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. Farmers and ranchers need a tax code that recognizes the financial challenges that impact agricultural producers.

Farm Bureau supports tax laws that help the family farms and ranches that grow America's food and fiber, often for rates of return that are modest compared to other businesses opportunities. What is needed are tax policies that support high-risk, high-input, capital-intensive businesses like farms and ranches that predominantly operate as sole proprietors and pass-through entities.

The House of Representatives is moving forward with comprehensive tax reform designed to spur growth of our nation's economy. Many of the provisions of the tax reform blueprint will be beneficial to farmers, including reduced income tax rates, reduced capital gains taxes, immediate expensing for all business inputs except land and the elimination of the estate tax. The proposed loss of the deduction for business interest expense, however, is a cause for concern. The blueprint can be improved by guaranteeing the continuation of stepped-up basis, preserving cash accounting and maintaining like-kind exchanges.

The testimony that follows focuses on and provides additional commentary on the tax reform issues most important to farmers and ranchers.

LOWER EFFECTIVE TAX RATES WILL BENEFIT FARM AND RANCH BUSINESSES

Farm Bureau supports reducing tax rates and views this as the most important goal of tax reform. Tax reform must be comprehensive and treat farm and ranch businesses that operate as individuals, pass-through businesses and corporations fairly. More than 94 percent of farms and ranches are taxed under IRS provisions affecting individual taxpayers. Tax reform that fails to treat sole proprietors, partnerships and S corporations fairly will not help, and could even hurt, the bulk of agricultural producers who operate outside of the corporate tax code.

While lower tax rates are important, the critical feature for farmers and ranchers is the effective tax rate paid by farm and ranch businesses. Tax reform that lowers rates by expanding the base should not increase the overall tax burden (combined income and self-employment taxes) of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions for all rate brackets could result in a tax increase for agriculture.

Farming and ranching is a cyclical business where a period of prosperity can be followed by one or more years of low prices, poor yields or even a weather disaster. Tax code provisions like income averaging allow farmers and ranchers to pay taxes at an effective rate equivalent to a business with the same aggregate but steady revenue stream. Farm savings accounts would accomplish the same object plus allow a famer or rancher to reserve income in a dedicated savings account for withdrawal during a poor financial year. Currently one of the main mechanisms farmers have to move money from one year to the next is by purchasing new equipment or other inputs. Farm savings accounts would give farmers much more flexibility in money management.

ACCELERATED COST RECOVERY HELPS FARMERS REMAIN EFFICIENT

Expensing allows farm and ranch business to recover the cost of business investments in the year a purchase is made. Because production agriculture has high input costs, Farm Bureau places a high value on the immediate write-off of equipment, production supplies and pre-productive costs.

The value of expensing has been widely acknowledged by Congress as recently as 2015 with passage of the PATH Act, which made permanent the $500,000 level of Sect. 179 small businesses expensing. The tax code also provides immediate cost recovery through bonus depreciation and through long standing provisions that allow for the expensing of soil and water conservation expenditures, expensing of the costs of raising dairy and breeding cattle and for the cost of fertilizer and soil conditioners like lime.

When farmers are not allowed immediate expensing they must capitalize purchases and deduct the expense over the life of the property. Accelerated deductions reduce taxes in the purchase year, providing readily available funds for upgrading equipment, to replace livestock, to buy production supplies for the next season and for farmers to expand their businesses.

CASH ACCOUNTING HELPS FARM AND RANCH BUSINESSES TO CASH FLOW

Cash accounting is the preferred method of accounting for farmers and ranchers because it allows them to match income with expenses and aids in tax planning. Farm Bureau supports the continuation of cash accounting.

Cash accounting allows farmers and ranchers to improve cash flow by recognizing income when it is received and recording expenses when they are paid. This provides the flexibility farmers need to plan for major business investments and in many cases provides guaranteed availability of some agricultural inputs.

Under a progressive tax rate system, farmers and ranchers, whose incomes can fluctuate widely from year to year, will pay more total taxes over a period of time than taxpayers with more stable incomes. The flexibility of cash accounting also allows farmers to manage their tax burden on an annual basis by controlling the timing of revenue to balance against expenses and target an optimum level of income for tax purposes.

Loss of cash accounting would create a situation where a farmer or rancher might have to pay taxes on income before receiving payment for sold commodities. Not only would this create cash flow problems, but it also could necessitate a loan to cover ongoing expenses until payment is received. The use of cash accounting helps to mitigate this challenge by allowing farm business owners to make tax payments after they receive payment for their commodities.

DEDUCTING INTEREST EXPENSE IS IMPORTANT FOR FINANCING

Debt service is an ongoing and significant cost of doing business for farmers and ranchers who must rely on borrowed money to buy production inputs, vehicles and equipment, and land and buildings. Interest paid on these loans should be deductible because interest is a legitimate business expense.

Farm and ranch businesses are almost completely debt financed with little to no access to investment capital to finance the purchase of land and production supplies. In 2015, all but 5 percent of farm sector debt was held by banks, life insurance companies and government agencies. Without a deduction for interest, it would be harder to borrow money to purchase land and production inputs and the agriculture sector could stagnate.

Land has always been farmers' greatest assets, with real estate accounting for 79 percent of total farm assets in 2015. Since almost all land purchases require debt financing, the loss of the deduction for mortgage interest would make it more difficult to cash flow loan payments and could even make it impossible for some to secure financing at all. The need for debt financing is especially critical for new and beginning farmers who need to borrow funds to start their businesses.

REPEALING ESTATE TAXES WILL AID IN FARM TRANSISTIONS

Estate taxes disrupt the transition of farm and ranch businesses from one generation to the next. Farm Bureau supports estate tax repeal, opposes the collection of capital gains taxes at death and supports the continuation of unlimited stepped-up basis.

Farming and ranching is both a way of life and a way of making a living for the millions of individuals, family partnerships and family corporations that own more than 99 percent of our nation's more than 2 million farms and ranches. Many farms and ranches are multi-generation businesses, with some having been in the family since the founding of our nation.

Many farmers and ranchers have benefited greatly from congressional action that increased the estate tax exemption to $5 million indexed for inflation, provided portability between spouses, and continued the stepped-up basis. Instead of spending money on life insurance and estate planning, farmers are able to upgrade buildings and purchase equipment and livestock. And more importantly, they have been able to continue farming when a family member dies without having to sell land, livestock or equipment to pay the tax.

In spite of this much-appreciated relief, estate taxes are still a pressing problem for some agricultural producers. One reason is that the indexed estate tax exemption, now $5.49 million, is still catching up with recent increases in farmland values. While increases in cropland values have moderated over the last three years, cropland values remain high. On average cropland values are 62 percent higher than they were a decade ago. As a result, more farms and ranches now top the estate tax exemption. With 91 percent of farm and ranch assets illiquid, producers have few options when it comes to generating cash to pay the estate tax.

REDUCED TAXATION OF CAPITAL GAINS ENCOURAGES INVESTMENT

The impact of capital gains taxes on farming and ranching is significant. Production agriculture requires large investments in land and buildings that are held for long periods of time during which land values can more than triple. Farm Bureau supports reducing capital gains tax rates and wants an exclusion for farm land that remains in production.

Capital gains taxes are owed when farm or ranch land, buildings, breeding livestock and timber are sold. While long-term capital gains are taxed at a lower rate than ordinary income to encourage investment and in recognition that long-term investments involve risk, the tax can still discourage property transfers or alternatively lead to a higher asking price.

Land and buildings typically account for 79 percent of farm or ranch assets. The current top capital gains tax is 20 percent. Because the capital gains tax applies to transfers, it provides an incentive to hold rather than sell land. This makes it harder for new farmers and producers who want to expand their business, say to include a child, to acquire property. It also reduces the flexibility farm and ranches need to adjust their businesses structures to maximize use of their capital.

STEPPED-UP BASIS REDUCES TAXES FOR THE NEXT GENERATION OF PRODUCERS

There is also interplay between estate taxes and capital gains taxes: stepped-up basis. Step-up sets the starting basis (value) of land and buildings at what the property is worth when it is inherited. Capital gains taxes on inherited assets are owed only when sold and only on gains over the stepped-up value. If capital gains taxes were imposed at death or if stepped-up basis were repealed, a new capital gains tax would be created and the implications of capital gains taxes as described above would be magnified.

Stepped-up basis is also important to the financial management of farms and ranches that continue after the death of a family member. Not only are land and buildings eligible for stepped- up basis at death but so is equipment, livestock, stored grains, and stored feed. The new basis assigned to these assets resets depreciation schedules providing farmers and ranchers with an expanded depreciation deduction.

LIKE-KIND EXCHANGES HELP AG PRODUCERS STAY COMPETITIVE

Like-kind exchanges help farmers and ranchers operate more efficient businesses by allowing them to defer taxes when they sell assets and purchase replacement property of a like-kind. Farm Bureau supports the continuation of Sect. 1031 like-kind exchanges.

Like-kind exchanges have existed since 1921 and are used by farmers and ranchers to exchange land and buildings, equipment, and breeding and production livestock. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to continue their farm or ranch businesses or, worse yet, delay mandatory improvements to maintain the financial viability of their farm or ranch.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since January 1, 2015.

Name: Patricia A. Wolff

Organization you represent (if any): American Farm Bureau Federation

1. **Please list any federal grants or contracts (including subgrants and subcontracts) <u>you</u> have received since January 1, 2015, as well as the source and the amount of each grant or contract. House Rules do <u>NOT</u> require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source: N/A **Amount:** ______

Source: ______ **Amount:** ______

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) <u>the organization</u> has received since January 1, 2015, as well as the source and the amount of each grant or contract:**

Source: N/A **Amount:** ______

Source: ______ **Amount:** ______

3. **Please list any payment or contract originating with a foreign government (including subcontracts) <u>you</u> have received since January 1. 2015, as well as the country of origin and amount of each payment or contract.**

Country of Origin: N/A **Amount:** ______

Country of Origin: ______ **Amount:** ______

4. **Please list any payment or contract originating with a foreign government (including subcontracts) <u>the organization</u> has received since January 1. 2015, as well as the country of origin and amount of each payment or contract.**

Country of Origin: N/A **Amount:** ______

Country of Origin: ______ **Amount:** ______

Please check here if this form is NOT applicable to you: ______

Signature: ______________________________

* Rule XI, clause 2(g)(5) of the U.S. House of Representatives provides:

(A) Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof.

(B) In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of any Federal grants or contracts, or contracts or payments originating with a foreign government, received during the current calendar year or either of the two previous calendar years by the witness or by an entity represented by the witness and related to the subject matter of the hearing.

(C) The disclosure referred to in subdivision (B) shall include--(i) the amount and source of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) related to the subject matter of the hearing; and (ii) the amount and country of origin of any payment or contract related to the subject matter of the hearing originating with a foreign government.

(D) Such statements, with appropriate redactions to protect the privacy or security of the witness, shall be made publicly available in electronic form not later than one day after the witness appears.

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.

Committee on Agriculture
U.S. House of Representatives
Information Required From Nongovernmental Witnesses

House rules require nongovernmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. **Name:**____

2. **Organization you represent:**

   ____

3. **Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee:** ____

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4. **Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee:** ____

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5. **If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold:**

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PLEASE ATTACH THIS FORM OR YOUR BIOGRAPHY TO EACH COPY OF TESTIMONY.

Patricia A. Wolff
Senior Director, Congressional Relations
American Farm Bureau Federation

Pat Wolff serves as an American Farm Bureau Federation lobbyist and is the organization's tax specialist. She also follows Affordable Care Act issues.

With over six million member families, AFBF is the nation's largest general farming organization, representing farmers and ranchers.

The organization's current tax priorities include comprehensive tax reform, effective tax rates, estate taxes, capital gains taxes and cost recovery.

Prior to joining AFBF, Pat lobbied for the Pennsylvania Farm Bureau and administered PFB's political action committee. She started her Farm Bureau career as an organization director for the Ohio Farm Bureau.

Pat holds a Masters Degree in Public Administration and a Bachelor of Science degree in Agricultural Economics and Rural Sociology, both from Penn State University.

She is recognized as a Certified Association Executive by the American Society of Association Executives and as a Distinguished Toastmaster by Toastmasters International.

Pat lives in Rockville, Md., with her husband, Howard Jung, and has two adult children, Rachel and Adam.