



Graphic owner: UKZN SAEES: school website

September 28, 2016
Volume 16, Issue 9

*Edited by Will Snell
& Phyllis Mattox*

FEATURED ARTICLES

**Alternative Tax
Savings with Grain**
- Lauren O. Turley

**The Winter Wheat
Safety-Net Adjusts
Lower Again for 2017**
- Todd Davis

**Income Tax
Seminars Reach
50-Year Milestone**
- Steve Isaacs

**Food Price
Deflation?**
- Will Snell

Alternative Tax Savings with Grain

Harvest is in full swing across the state and this is the prime time for grain producers to be thinking about gifting grain or paying wages in commodities. Commodities can be an effective alternative to cash, if utilized. There are several advantages that should be taken into consideration when weighing the options, including tax savings depending on the option chosen.

Commodities can be gifted to family members and/or charities. Regardless of who the commodity is gifted to, the producer must convey title of the unsold commodity to the beneficiary and then the beneficiary can sell the commodity. Farm proprietors, partnerships, and corporations can make charitable gifts of unsold commodities. However, only farm proprietors and partners can make commodity gifts to family members. If a corporation owns the grain, the corporation is taxable on the value of the grain distributed. Gifts to family members should be made after the end of the year in which the production costs have been incurred. If the gift is made in the same year as the costs are incurred, then some of those costs must shift to the beneficiary.

If gifts to any one family member exceed \$14,000 for a calendar year, a federal gift tax return must be filed and the gifts in excess of the \$14,000 will use a portion of the estate tax exemption. Family members who receive the grain will pay tax on the grain once it is sold. One advantage of gifting to a non-farming relative, is that the family member will be exempt from paying self-employment tax on the grain and will only pay income tax. The beneficiary will report the sale of grain on Schedule D as a short-term capital gain with a zero tax cost. If any of the beneficiaries are under age 19 or a college student under age 24, the "kiddie tax" will apply the parental tax rate rather than the child's rate to the income. This strategy of gifting allows the producer to shift income to children or other family members who may be in a lower tax bracket.

Gifts of grain to a charitable organization can far outweigh the tax advantages of a cash contribution. Gifting grain should result in a lower adjusted gross income for the producer since the sale of the grain will not be reported as income, but the costs of producing the grain are deductible as a business expense on Schedule F. As a result, the amount of income and self-employment tax owed should be reduced. Having the reduction in income may be more advantageous since many farmers do not have enough deductions to itemize personal deductions, but rather claim the standard deduction on the tax return. In this case, they would receive no deduction for the charitable contribution.

Before making a charitable gift of grain, the organization should be contacted to make sure they can accept the donation. The producer needs to give up dominion and control of the grain and should present a letter to the charity detailing the commodity and the quantity of the commodity being gifted. The producer should also ask the charity where they want the grain delivered. The charity will sell the grain and receive a check from the elevator. Technically, the producer cannot sell the grain and tell the elevator to send the check to the charity, as this would not demonstrate giving up dominion and control of the grain. The producer should get a receipt from the charity for the amount of the donation. The donation should not be reported on Schedule A, for the tax benefit comes from deducting the expenses and not reporting the sale of the grain on the Schedule F.

Farm employees can also be paid in commodities. This can be a useful tax savings tool to pay farm wages to spouses, children over 18, or other hired employees who are subject to FICA tax. The main advantage of commodity wages is that these wages are exempt from social security and Medicare tax for both the employee and the employer. For the employer, these wages are also exempt from unemployment tax. The wages must be paid for agricultural labor and, similar to the gifted grain, the employee must exercise dominion and control over the commodity. The employer must include the fair market value of the commodity transferred in the employee's gross wages. This should be included on the W-2 as the value of the commodity at the time of transfer. In the case of commodity wages, the farmer would claim a deduction equal to the fair market value of the commodities at the time of transfer as a wage expense on the Schedule F, but would also include the value as a sale of grain. This would create a net effect of zero on the Schedule F. Similar to the recipient of the gifted grain, the employee would include the gain or loss (difference in sale price and the value of grain on date of transfer) on the commodity sold as a short-term gain or loss on Schedule D when the commodity is sold. One disadvantage of commodity wages is that the employee's account is not credited for social security benefit purposes.

As the farm economy has weakened and cash may not be readily available, the option of using commodities may be more attractive. Consider gifting grain to relatives or charities to take advantage of tax savings. Discuss the option of commodity wages with employees. Grain producers are fortunate to have the ability to use commodities as an alternative to cash in these situations and should consider using this tax-savings tool. If you have any questions about gifting grain or using commodities as wages, please contact your Kentucky Farm Business Management specialist.



Lauren O. Turley, lauren.o.turley@uky.edu
 Area Extension Specialist
 KFBM Ohio Valley Farm Analysis Group

Income Tax **Seminars Reach 50-Year Milestone**

The 50th year of Income Tax Seminars will be offered at fifteen locations around the state in October, November, December, and January. The two day seminars are targeted toward tax preparation professionals and financial advisors. Participants are eligible for up to 17 hours of continuing education credit.

| Location | Dates |
|--------------------|----------------|
| Hopkinsville | Oct 27-28 |
| Maysville | Nov 2-3 |
| Paducah | Nov 2-3 |
| Prestonsburg | Nov 9-10 |
| Louisville/East | Nov 9-10 |
| Lexington/North | Nov 14-15 |
| Bowling Green | Nov 17-18 |
| Grayson | Nov 21-22 |
| Burlington #1 | Nov 29-30 |
| Elizabethtown | Nov 30 - Dec 1 |
| Lexington/Downtown | Dec 5-6 |
| Owensboro | Dec 6-7 |
| Somerset | Dec 13-14 |
| Louisville/Airport | Dec 14-15 |
| Burlington #2 | Jan 4-5 |

Seminars are taught by two teams of experienced instructors with extensive backgrounds in state and federal taxes. The EAST Team instructors are Bill Klump, CPA and President of Klump & Blandford, PSC and Willa Woolfolk a retired IRS agent. The WEST Team has two new instructors: Bill Eversole, Managing Member of Summit Strategic Advisors, LLC and James Blandford, CPA and Vice-President of Klump and Blandford, PSC. The farm tax components are taught by KY Farm Business Management specialists and state updates are offered by Kentucky Department of Revenue staff. Additionally, an Internal Revenue Service representative will provide information about the IRS Taxpayer Advocate Service at each seminar location.

Seminar cost is \$325, and early registration is encouraged as some locations fill quickly. Registration within two weeks prior to each seminar is \$365.

All seminar dates and locations are listed in the chart at left. For registration and additional information see the UK Income Tax Seminar website at www.uky.edu/uktax/.

Last year 1,606 registrants attended a UK Income Tax Seminar. Registration for the 50th year of seminars is underway. For additional information see the website listed above or contact Kathy Roe or Emily Brown, UK Income Tax Seminar Program Coordinators, at 859-218-5112, 859-218-3661, or toll free at 888-808-3303. You can also email Kathy or Emily at Kathy.roe@uky.edu or e.brown@uky.edu.

Steve Isaacs, sisaacs@uky.edu
 Director, UK Tax Education Program
 Extension Professor & Coordinator

The Winter Wheat Safety-Net Adjusts Lower Again for 2017

The 2014 Farm Bill made crop insurance the primary safety-net program with the traditional Title I farm bill programs of Agricultural Risk Coverage (ARC) or the Price Loss Coverage (PLC) in place to provide additional shallow loss coverage. Revenue Protection (RP) crop insurance is more widely used than the yield only products due to the ability to insure against lower yields and/or lower prices at harvest. RP insurance price protection is based on the commodity futures prices prior to planting and harvest. The price protection ebbs and flows with the market from year-to-year which means that the safety-net protection can vary significantly from the previous crop-year. Figure 1 shows the crop insurance final insurance price guarantee from 2007 to 2017. Unless prices increase at harvest-time, the 2017 price guarantee is \$0.45/bushel lower than last year's price protection and \$3.98/bushel lower than the price protection provided by RP insurance for the 2013 crop.

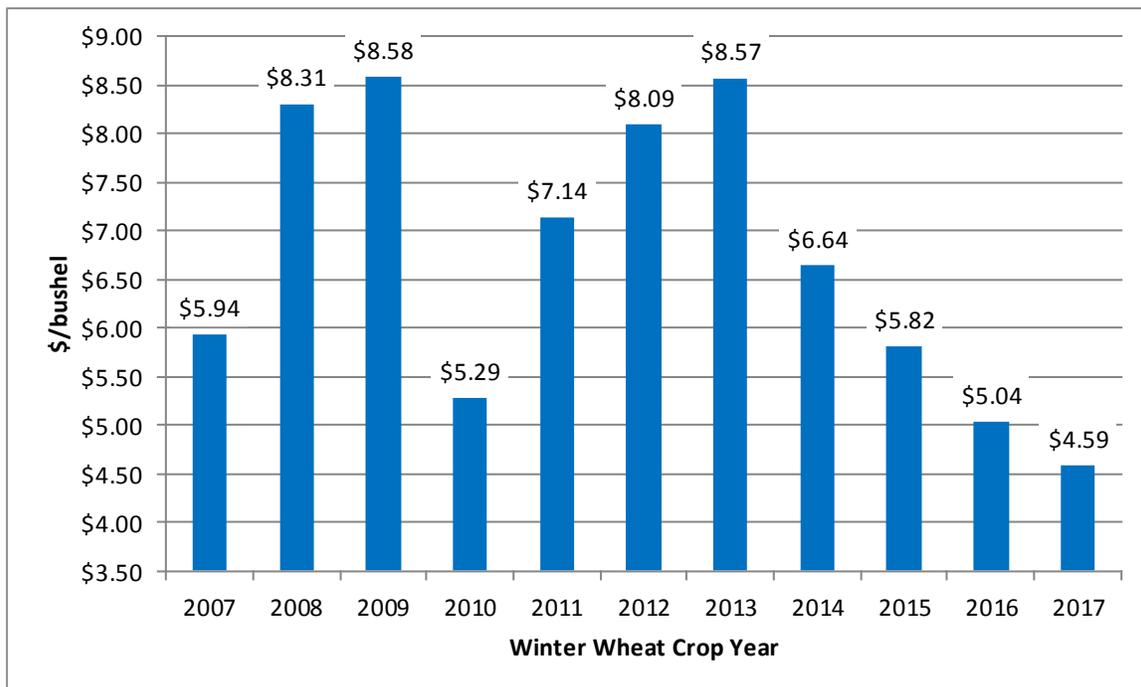


Figure 1. Winter Wheat Final Price Guarantee for Revenue Protection Insurance from 2007-2017.

How has this revenue safety-net changed since 2013? Figure 2 shows the revenue guarantee provided for a wheat farm with an insured yield of 70 bushels per acre for RP insurance coverage levels ranging from 60% to 85% of the insured yield. Like any insurance product, there is a deductible which means that farmers are not able to insure at the full value of expected revenue; hence, the maximum coverage is limited to 85% of the insured yield.

Figure 2 compares the revenue protection provided by the 2013, 2016 and 2017 RP projected prices. The insured prices for RP insurance for wheat in 2013, 2016 and 2017 were \$8.57, \$5.04 and \$4.59 per bushel, respectively. The 2017 projected budgeted total variable cost for wheat of \$276 per acre (red line) and the total variable cost plus cash rent of \$466 per acre (black line) based on preliminary UK crop enterprise budgets are also included in Figure 2.

As commodity prices have fallen significantly from 2013, the safety-net RP insurance provides is much lower protection relative to total variable costs plus cash rent. At the 2013 projected prices (blue bar), it may have been possible to have a safety-net that covered total variable costs plus cash rent at the 80% coverage level. For 2016 (green bar), a revenue guarantee at the 80% coverage level may just cover total variable costs but not cash rent expense. For 2017 (red bar), protection at the 85% coverage level may just cover projected total variable costs of producing wheat.

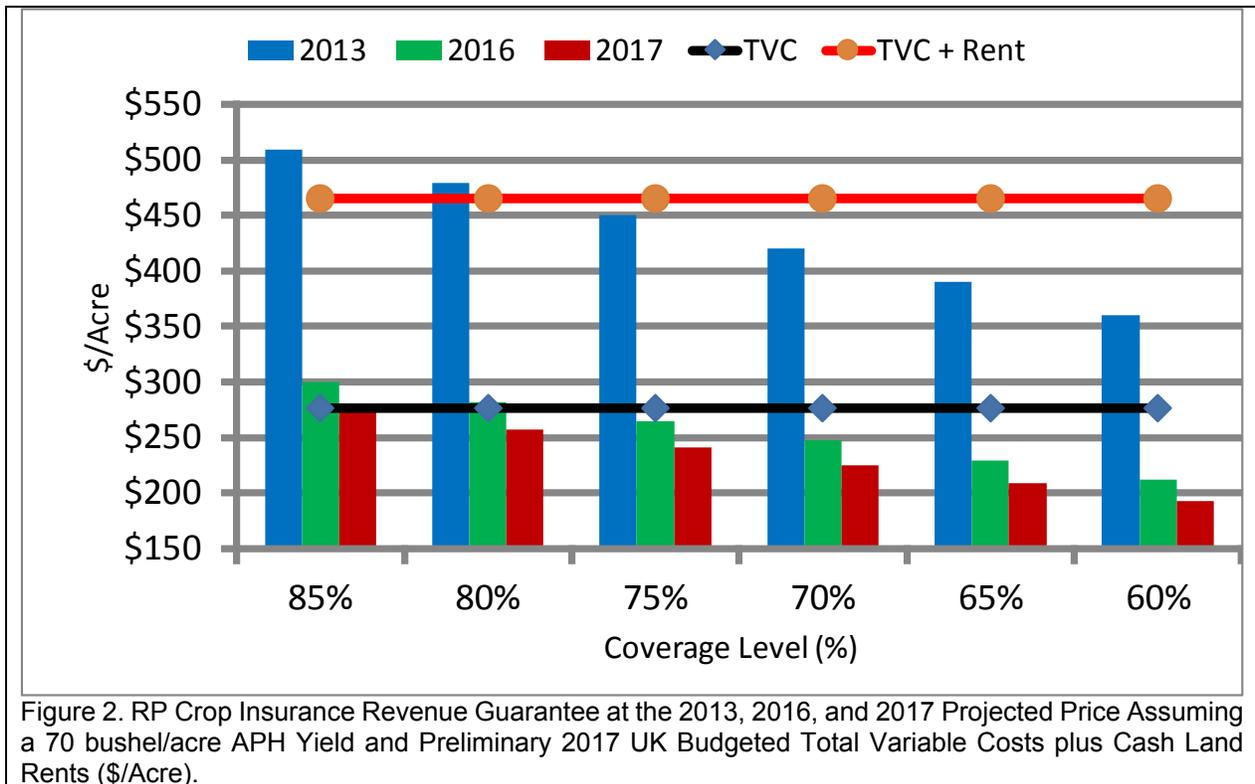


Figure 2 shows that the revenue guarantee at the 75% coverage level declined from \$450/acre in 2013 to \$241/acre for 2017 (Figure 2). Farmers have lost \$209/acre in revenue protection at the same coverage level from 2013 to 2017 assuming the same insured yield. Those normally purchasing RP insurance at the 65% coverage level have experienced a \$181/acre reduction in revenue guarantee from 2013 to 2017 assuming the same insured yield (Figure 2).

Implications for Grain Farmers

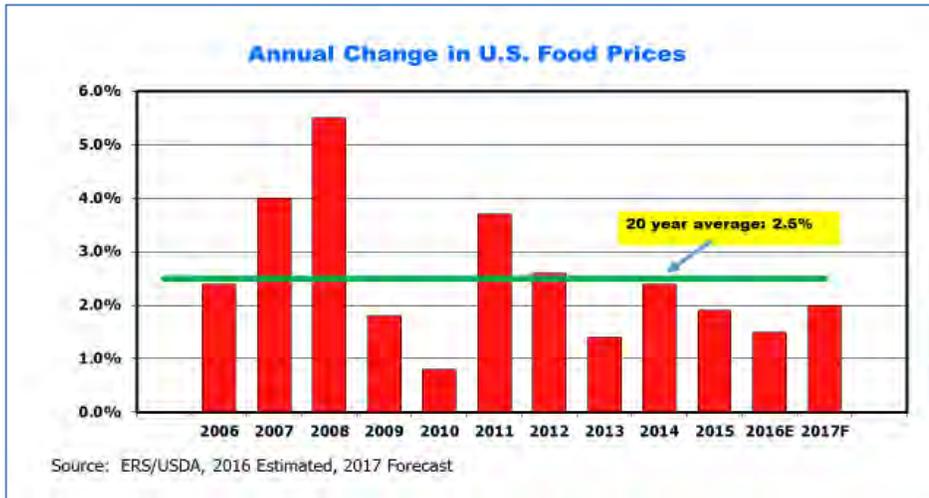
Current profitability projections suggest that farmers will have to prepare to manage negative margins for the 2017 wheat crop unless they harvest larger than expected yields or receive higher than expected prices at harvest. The projected negative margins will need to be off-set by very profitable double-crop soybeans, increased operating debt or use of the farm's working capital. The RP insurance safety-net is not providing the same protection as in previous crop years suggesting that managers will need to be diligent with pricing opportunities and reduce costs wherever possible.

The positive aspect of crop insurance is that indemnities are paid as soon as possible whenever losses are incurred. The farm bill programs do not make payments until October after the end of the commodity's marketing-year. This means that any ARC or PLC payments for the 2017 wheat crop would not be received by farmers until October 1, 2018, at the earliest. While every dollar helps with managing cash flow deficits, the timing of the farm program payments will not provide immediate relief for farms with liquidity problems.

Todd D. Davis, todd.davis@uky.edu
Assistant Extension Professor

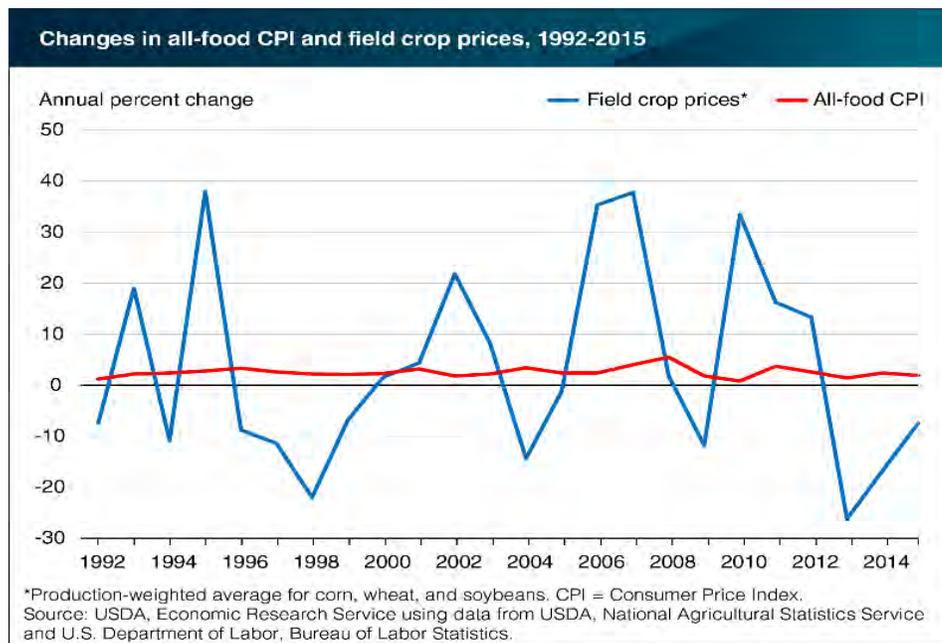
Food Price Deflation???

The prices U.S. consumers paid for food increased on average 2.5% annually from 1991 to 2007, before increasing 4% in 2007 and an 18-year high of 5.5% in 2008. Some media reports and analysts claimed at that time that the era of “cheap” food was over and warned consumers to expect much higher food price inflation in the future as farm commodity prices would remain well above historical levels. Much of the blame was directed toward our nation’s energy policy which resulted in a relatively high percentage of our corn crop being used to produce fuel and not being available for feed for livestock and eventually food for consumers.



While higher farm commodity prices did contribute to higher food prices at that time, certainly then, as well as now with much lower farm commodity prices, the price we pay for many of our food items is impacted more by changes in marketing costs (e.g. labor, transportation, packaging, storage, etc.) and other global factors than the prices farmers receive. USDA estimates that the farm value for every \$1 that the U.S. consumer spends on food is around 17 cents.

The farm value for food consumed away-from-home is much lower – less than 6 cents per consumer food dollar compared to 26 cents for food consumed at home. Consequently, significant changes in farm commodity prices will have a much greater impact on food costs at the supermarket than on the price of food we pay at a restaurant. In general, marketing costs (with the exception of transportation costs) are fairly stable, resulting in farm commodity prices being much more volatile than food prices – see chart below.



While the farm value is a relatively small portion of the consumer food dollar, today’s lower ag commodity prices are putting a lid on food prices. Some food items such as meats, milk, eggs have a much greater farm value than processed and packaged food items. Consequently, increasing farm supplies of beef, milk, and eggs have resulted in some noticeable price declines for these products at the grocery store in recent months. But lower grain prices have minimal impact on the price of a box of cereal, a loaf of bread and many of the processed food and beverage items. Today’s intense competition in the food/restaurant markets, relatively lower fuel prices, stagnant wages,

automation efficiencies, economies of scale, and access to lower priced imports (aided by a strengthening U.S. dollar), along with lower commodity prices are collectively contributing to almost zero food price inflation so far in 2016.

According to the USDA food price index released last week, U.S. food prices are virtually unchanged over the past 12 months with food prices away from home up 2.8%, but food consumed at home, down 1.9% from August 2015 (see table below). Beef and egg prices are noticeably lower with fruits, cereals, and vegetables fairly stable. For the year, USDA is projecting U.S. food price inflation to be in the 1 to 2% range, with food price increases expected to remain below historical averages in 2017.

| Percent Changes in Food Prices | | | | | |
|---|----------------------------|------|----------------------------|----------------|-------------|
| Item | 20-Year Historical Average | 2015 | August 2015 to August 2016 | Forecast | Forecast |
| | | | | 2016 | 2017 |
| All food | 2.6 | 1.9 | 0.0 | 1.0 to 2.0 | 1.5 to 2.5 |
| Food away from home | 2.7 | 2.9 | 2.8 | 2.5 to 3.5 | 2.0 to 3.0 |
| Food at home | 2.5 | 1.2 | -1.9 | -0.5 to 0.5 | 1.0 to 2.0 |
| Selected Foods | | | | | |
| Beef | 4.5 | 7.2 | -7.0 | -5.5 to -4.5 | 2.0 to 3.0 |
| Pork | 2.5 | -3.9 | -2.0 | -3.0 to -2.0 | 0.0 to 1.0 |
| Poultry | 2.6 | 0.4 | -2.9 | -2.0 to -1.0 | 1.5 to 2.5 |
| Eggs | 4.9 | 17.8 | -37.9 | -19.0 to -18.0 | -0.0 to 1.0 |
| Diary Products | 2.7 | -1.3 | -2.4 | -1.5 to -0.5 | 1.5 to 2.5 |
| Fresh Fruits | 2.4 | -2.2 | 1.7 | 1.5 to 2.5 | 1.0 to 2.0 |
| Fresh Vegetables | 2.7 | 1.6 | -0.2 | 0.5 to 1.5 | -0.5 to 0.5 |
| Cereals and Bakery Products | 2.5 | 1.1 | -0.7 | 0.5 to 1.5 | 1.5 to 2.5 |
| Source: Bureau of Labor Statistics. Forecasts by Economic Research Service (September 23, 2016) | | | | | |



Will Snell, wsnell@uky.edu
 Extension Professor



University of Kentucky Department of Agricultural Economics

315 Charles E. Barnhart Bldg. Lexington, KY 40546-0276

Phone: 859-257-7288 Fax: 859-257-7290

<http://www.uky.edu/Ag/AgEcon/extbluesheet.php>