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IMPORTANT INFORMATION ON THE TOBACCO SETTLEMENT

by Waylon Ramming



This year Kentucky tobacco producers will receive the first of 12 installments of the National Tobacco Settlement. Kentucky's share will be \$112.71 billion for 1999. In order to get the funds distributed as quickly as possible, the distribution will be based upon 1998 production information. The pool of money is going to be split among the unique factors of tobacco production: 1.) quota, 2.) land, 3.) management and labor. Forms will be mailed to quota owners September 15th to the 17th. Completed forms must be postmarked by October 8th. Checks are to be mailed by December 31st.

There are some important considerations regarding filling out the forms. You must mail in the ORIGINAL form you received in the mail. If for any reason it is destroyed or damaged you must phone the Kentucky Tobacco Settlement Trust Corporation and request a replacement form at the

earliest possible time. Their phone number is 1-888-366-8698.

The scanner which reads the forms requires **black ink**. Any markings outside the boxes or corrections will likely make the form unreadable to the scanner. Forms that do not feed through the scanner will be manually corrected. No one knows how that process will work or how long it will take. It is extremely important you fill out the forms exactly as instructed. You may want to make a photocopy to practice on; but be sure to mail in the original.

The quota pool is being split according to basic quota per FSA records as of July 1, 1998. Quota owners will receive forms from the Kentucky Tobacco Settlement Trust Corporation. There will be some information preprinted on the forms. For quota owners basic quota will be listed. The owner of record is being asked to allocate who should receive the payment for basic quota. In most all cases this would be the person who received the form. There may be a few cases where husband and wife or other family members may want to split the quota payment. The quota owners will be paid 8.65¢/lb.

The second portion will be paid to those who control the land where the tobacco was grown in 1998, and shares in the risk of production. Let us consider a land owner who had her

tobacco pounds grown on her land and received her income based upon a share of the crop at marketing. Since the crop must be grown and marketed she is at risk and eligible for the growing farm payment. If she cash leased her land and was protected from any production risk she is not going to receive the growing farm payment. As a grower, you should receive the growing farm payment in at least two situations. The first is when the pounds you own are grown on land under your control (either your land or cash leased land.) Second would be when you cash leased pounds to grow on land under your control. The payment pounds for the growing farm payment is the average of the effective quota and the 1998 crop marketings. The payment rate is 7.84¢/lb.

The grower payment is meant to be received by the person who bears the production risk associated with providing labor to grow the crop. Since contractors bear no production risk, they are ineligible. When the grower must produce and market the crop to receive any income he is the at risk party who will receive the payment. The rate for grower pounds is also 7.84¢/lb.

For each of the three payment pools the question should be asked who was at risk and should receive this additional return. The person who invests and holds quota is fairly straightforward in receiving an additional rent. The persons who own/control the land will get their additional rent in return for their risk. The person who invests in labor and the associated costs of production will receive the grower payment.

The tobacco companies have stated they want this money distributed by

December 31st for their tax planning needs. The tobacco settlement funds will not be subject to Kentucky Income Tax. Currently the federal taxation status is undecided. People receiving money from the TSTC must provide a Social Security Number or FEIN to avoid federal back-up withholding of 31%. If the bill to exempt the trust funds from Federal Income tax does not pass, it is likely receiving parties will get some type of information return for the tax year 1999. Keep this in mind when doing tax planning this fall. Even if you don't receive payment until the last few days of the year or even into January of 2000, the 1099 will likely be dated for the 1999 tax year.

The confusion in filling out the form will arise from allocating the pounds reported to you. Remember, the persons at risk should get paid. The worst thing that can happen is to not settle any disagreements, and fail to get the form filed timely. There will be no second chances. This is an ongoing process. Final review of the forms will not be completed until right before they are mailed. Contact your County Extension Office to find out when and where the nearest meeting is being held on the tobacco settlement. Extension has the primary education role in the settlement process and is working with state agencies and the FSA offices to implement this settlement as smoothly as possible.

THE IMPACT OF LDPs IN YOUR MARKETING PLAN

by Craig D. Gibson



The assumption that all producers have a **written marketing plan** is

probably a "stretch" at best. Regardless, it is a grave error to omit from this narrative the statement that **all producers should always have a written marketing plan.** A written marketing plan allows a producer to have something upon which to react. It definitely appears that producers should immediately review their marketing plans with considerations given to on-farm storage and loan deficiency payments. In today's environment, management of LDPs is an important ingredient in each producer's marketing plan.

Loan Deficiency Payments (LDPs)

A loan deficiency payment is a payment made to a producer who, although eligible to obtain a Commodity Credit Corporation (CCC) loan, agrees to forgo the loan in return for a payment on the eligible commodity. The LDP payment is determined as the difference between the County Loan Rate and the Posted County Price (PCP). The PCP and LDP rate are available each business day from the county Farm Service Agency (FSA) office and are effective from 7:00 a.m. to close of business each business day.

At this point in time, LDPs and marketing loan gains are subject to a \$75,000 per person payment limitation for all crops during a crop year (not a calendar year). If that limit is reached, a producer can place bushels of crops in which no LDP or marketing loan gain has been received, but otherwise qualify, under a nine-month CCC loan. If at loan maturity, prices are not greater than the loan rate, a producer may "forfeit" the grain under a loan to the government and thereby still be guaranteed of the crop's loan rate. If during the nine-month period, market

prices exceed the loan rate (plus accrued interest), a producer can still sell the grain under the loan and repay the loan plus accrued interest to CCC and possibly realize a market price above the crop loan rate.

There are some that suggest that the \$75,000 per person limitation will be increased to \$150,000. However, it is also suggested that this increase will be connected to a comprehensive farm-aid bill. Although committee discussion is underway, the bill will most likely not be formally addressed by Congress until this fall, after the 1999 production level becomes closer to being known.

A producer cannot sell or “pass title” on the commodity before requesting the LDP or placing the commodity under a nine-month CCC loan. In other words, a producer must have “beneficial interest” in the commodity as determined by title, risk of loss, and control. As a result, producers with potential payment limitations and limited storage capacity must do planning now. (It is most doubtful that warehouse receipts will be available by local elevators.)

For many producers, the determination of whether the LDP (and marketing gain) limitation will be reached is of first concern in determining whether any modifications are necessary in their marketing plan. Assistance may be provided by your Farm Analysis Specialist or County Agricultural Extension Agent in determining whether the LDP limitation of \$75,000 may be reached. Of course this determination is completely dependent upon the expected per bushel LDP to be captured and the number of bushels. Make sure in projecting LDPs that any LDPs or marketing gains captured on 1999 wheat are reflected!

Given that producers have determined expected production, storage capacity and potential LDPs and based on these results, market strategies begin to differ among producers as well as where their production will go at harvest. Strategies are now summarized by different scenarios.

Scenario 1. Limited Storage and No LDP Limitation Problem.

Currently, the market is telling producers to store wheat and then corn. If wheat is of no concern, then storage will be first utilized with corn, and then soybeans. However, if there are existing contracts for deferred delivery of soybeans, they must be stored, instead of corn.

Any “extra” bushels of soybeans will be sold as delivered at harvest. LDPs will be determined on the delivery date. Commercial storage charges appear “expensive” compared with deferred market prices. Therefore, if any producer wishes to maintain ownership of the delivered soybeans, this may be done with the purchase of call options or outright purchases of futures contracts.

Scenario 2. Limited Storage and LDP Limitation Problem.

Any deferred delivery contract must first be stored. After this storage is utilized, the issue becomes a matter of returns to storage versus capturing potential LDPs unavailable due to the \$75,000 per person limitation.

It appears, presently, that the potential LDP on soybeans is much greater than on corn. Furthermore, the

potential LDP for each crop is greater than the returns to storage. However, the method of preserving at least the loan rate will be through utilization of the nine-month CCC loan . . . which will most likely require on-farm storage.

Currently, it appears that a greater amount of the potential LDPs, unavailable due to the \$75,000 limitation, is preserved by placing soybeans under the nine-month CCC loan. It thereby seems reasonable that soybeans must be stored . . . instead of corn. Once all potential soybean LDPs are preserved, remaining on-farm storage may be utilized with corn.

Scenario 3. No Storage Limitation and No LDP Limitation Problem.

An immense amount of flexibility is found under this scenario. Most likely few producers will find themselves in this situation.

All grain will most likely be placed into on-farm storage. The exception will be any grain contracted for September through November delivery. To maximize returns-to-storage, grain will be sold for deferred delivery to take advantage of basis improvement and better deferred market prices. The largest challenge under this scenario will be when to establish the LDPs relative to marketing the wheat, corn, and/or soybeans in storage.

Scenario 4. No Storage Limitation and LDP Limitation Problem.

All grain will most likely be placed into on-farm storage, unless some is contracted for September through

November delivery. As much of the stored grain as the producer wishes may be placed under the nine-month CCC loan. Care will be required with respect to the bushels of grain redeemed before loan maturity so that the aggregate of LDPs and marketing gain does not exceed the \$75,000 per person limitation.

It is not hard to understand from a review of the four scenarios given that development of marketing strategies may first depend upon whether LDP preservation is of most importance. It is also important whether the use of on-farm storage must play an integral part of LDP preservation. Regardless, the bottom line is that one marketing strategy does not fit all. Each producer must identify strategies that work within the business constraints and be prepared if prices rise above respective loan rates.



**Other Information
Related to LDPs**

1. Loans and LDPs are available for eligible commodities from the time of harvest until the “final loan availability date.” For wheat, barley, oats, and canola, the final loan availability date is March 31 following the year in which the crop is typically harvested. For the other marketing assistance loan commodities, the final loan availability date is May 31 following the year in which the crop is typically harvested.

2. Form CCC-709 must be completed in advance of harvest and delivery of crops that are directly delivered to an elevator at harvest. Regardless of whether the crops are sold or placed under a “deferred pricing contract,” ownership of the grain has shifted to the elevator at

delivery and only with the completed Form CCC-709 is the LDP available. The LDP rate is based on the rate in effect the day of delivery for field direct deliveries. As with the producer, landlords must also complete form CCC-709 to be eligible for LDPs on grain delivered “field direct.”

3. For 1998 crops, an LDP or market gain payment was available for up to an additional 10 percent of the original LDP or loan quantity, if production evidence proved more than the original quantity. The payment for the additional quantity was based upon the LDP rate at the time the LDP was established on the original quantity. This is not the case for the 1999 crops.

For 1999, an LDP on any “overage” is not available . . . unless a producer meets the “ownership” test and files for an LDP on the overage amount. Caution is thereby advised. Producers must monitor quantities being delivered such that once the bushels delivered equal the bushels upon which LDPs have been taken, further delivery on any bushels remaining in the grain bin should not be delivered until another LDP filing with the County Farm Service Office is done (using a form CCC-666 LDP) on the remaining bushels.

4. Producers who will feed their corn instead of selling it need to consider paying for a measurement service to have acceptable production evidence. For most producers, there will not be required any production evidence for bushels that LDPs are taken. However, if a producer is one of the 5 percent selected for a “spot check” in each county, that producer must provide all required production evidence. Some substantiation or evidence will be required for any grain fed by a producer. Measurement available through the Farm Service Agency

provides needed evidence in such situations.

For producers that produce corn or milo silage, LDPs are available. Procedural differences are found in cases where silage is cut and immediately fed instead of being cut, placed into a silo, and fed at a later date. In either case, LDPs are based upon the corn or milo yield of remaining acreage harvested for grain. If no other corn or milo is harvested for grain, the county committee will make a yield determination for LDP purposes.

5. Once an LDP is received on bushels of grain, these bushels become ineligible for a nine-month CCC loan and a marketing loan repayment. However, if a nine-month CCC loan is received and the producer chooses to repay the loan in full, including the entire principal amount plus interest, the producer may then choose to claim an LDP on those same bushels at a later date.

Although this article has explained many of the basic facts concerning LDPs and marketing gains, producers must be aware that it is nearly impossible to cover every aspect or nuance. It is important that each producer understand the basic concepts.

Employing the concepts discussed is what management is all about. Hopefully this article will allow each reader to apply this information in the never-ending task of maximizing gross revenues through the capture of LDPs.

Note: The information provided in this material is believed to be correct. It is not intended to supercede any information or instruction provided by your local, state or national Farm Service Agency office.

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