
KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

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Not Getting the Right Farm Bill Option Can Cost You

Brian Lacefield

Selecting the wrong option when signing up for the new farm bill could cost you up to ten dollars an acre each year. Results from 108 Pennyroyal and Ohio Valley Area farms run through the University of Kentucky farm bill spreadsheet tool averaged a difference between the best and worst FSA option for each farm of \$9.89 acre/year. This figure assumes maximum counter-cyclical payments. Considering the farm bill is for six years, it is very important that each farm number be evaluated to determine the best option.

Additional results from the observations indicated that 75% of the farms benefited from updating base acres and yields, 58% using the 93.5% yield option and 17% using the 70% yield option. 25% of the farms observed would benefit greatest from maintaining existing base acres and yields and adding a soybean base. No farms in this study benefited from updating acres and not updating yields.

Table 1, on the following page, illustrates the average farm mix for the different options (ie, base acres and yields under the old program and 98-01 planting and yield history.) For farms that benefited from the minimal update (keeping old base and yields and adding soybeans) the planting history between 1998-2001 decreased acres for corn and wheat. Average planted corn acres decreased 34% from the old base, while wheat acres had a 37% decrease. Yields did increase for this group, however the increase was not enough to offset the reduction of acres. Maintaining the existing base and adding soybeans was the most beneficial option.

Farms that benefited from updating base acres and yields using the 70% yield option on average increased corn acres and decreased wheat acres. Planting history from 1998 through 2001 for this group increased corn acres 23% and decreased wheat acres 40%. Yields, however, increased for both crops. Corn yields increased 15% from existing PFC yields and wheat yields increased 37% from the old PFC yield. The increase in corn acres and improved yields for both wheat and corn were enough to offset the reduction in wheat acres. The soybean base added would be based on the average production history of 73-planted acres and a 34 bu/ac. yield.

Table 1. Summary of Spreadsheet Results

	Minimal Update	Update 70% Option	Update 93.5% Option
Farm Size (ac.)	249	198	304
Old Base (ac.)			
Corn	125	71	120
Wheat	67	49	67
Planting History (ac.)			
Corn	82	87	132
Wheat	42	35	76
Soybeans	101	73	119
Old Yield			
Corn	97	96	96
Wheat	40	41	40
New Yield			
Corn	120	110	142
Wheat	61	56	65
Soybeans	32	34	34

The majority of farms observed (58%) benefited from updating base acres and yields using the 93.5% yield option. The planting history for these farms increased corn and wheat acres, 7.5% and 13.4% respectively. Yields increased 48% for corn and 63% for wheat over the existing PFC yields. Planting history used to calculate the soybean base averaged 119 acres and 34 bu/ac.

Each farm number needs to be evaluated to determine the best option for the new farm bill. The University of Kentucky's spreadsheet tool can be downloaded at: www.uky.edu/Ag/AgEcon/farbill/decisiontools.html. If you have questions please contact your area farm management specialist or your county agent.

Agriculture Tax Seminars Planned

Six Agriculture Tax Seminars have been planned this fall across the state. Kentucky Farm Business Management Specialists will teach the six-hour seminars addressing new agriculture tax law and issues, pertinent past laws and tax planning.

Dates and locations of the seminars are as follows:

November 13	Henderson Co. Ext. Office
November 14	Hopkins Co. Ext. Office
November 15	Hardin Co. Ext. Office
November 20	Graves Co. Ext. Office
November 26	Adair Co. Ext. Office
December 3	Montgomery Co. Ext. Office

The seminars are open to anyone interested in learning about agriculture taxes. Starting time for each location will

be at 9:00 a.m. local time. Pre-registration is requested by contacting the Lincoln Trail Farm Business Management Office (270-737-4799). Cost for the seminars is \$60.

The Farm Bill Change to Cause Fall Cash-Flow Problems

Russ Morgan

An unforeseen and perhaps unintended result of the 2002 Farm Bill is a significant reduction in cash inflow this fall for farm producers as compared to 2001. Oddly, the primary culprit is an increase in commodity prices due to anticipated shortfalls in US crop production. On the surface this seems counter-intuitive unless you recognize the "counter-cyclical" nature of government payments as provided for in the 2002 Farm Bill - some government payments decrease as commodity prices increase. This occurs irrespective of whether an individual farmer has any crop to sell at these higher market prices.

In 2001, Market Loss Assistance (MLA) payments and Loan Deficiency Payments (LDP) were welcome income to cash-strapped farm producers in the fall of the production year. Commodity prices were low and many producers stored their crop hoping for prices to increase. MLA's were provided to producers to help offset the effects of historically low market prices on program crops. They were calculated by multiplying the program crop base acres (85%) times PFC yield times the MLA rate. LDP's were also a means by which producers could help offset low commodity prices on program crops and soybeans. LDP rates vary daily depending on a USDA calculation and could only be taken on actual production - no production, no LDP.

To illustrate the effects of producers NOT receiving MLA's and LDP's this fall, I have created a "synthetic" farm. Table 1, on the next page, provides total crop acres and program crop base

acres/yields for this synthetic farm which I will name KYJ farms. Table 2 provides the cropping program, yields and average LDP received by KYJ farms in 2001.

Table 1. Crop Acres, Base Acres/Yield and MLA

	Acres	PFC Yield	2001 MLA/bu
Total Crop	500		
Corn Base	300	95	.307
Wheat Base	145	45	.540
Sorghum Base	5	85	.368

Table 2. 2001 Crop Mix, Yields & LDP's

	Acres	Yield	Avg LDP
Corn	300	150	.22
Wheat	200	65	N/A
Soybeans	200	42	1.10

Based upon this information, KYJ farms received \$7,437.08, \$2,994.98, and \$132.94 MLA for corn, wheat and grain sorghum respectively. Additionally, KYJ farms was able to book \$9,900.00 and \$9,240.00 in LDP's for corn and soybeans respectively. (LDP's for wheat were assumed to be taken during the summer of 2001.) Total cash inflow from government payments tallied to \$29,705.00 in the fall of 2001.

Compare this to 2002's government payment prospects. Table 3 details KYJ farms' 2002 crop production and LDP information.

Table 3. 2002 Crop Mix, Yields & LDP's

	Acres	Yield	Avg LDP
Corn	200	100	.000
Wheat	300	55	N/A
Soybeans	300	32	.000

With the passage of the 2002 Farm Bill, MLA's are replaced by Counter-Cyclical Payments (CCP's); counter cyclical in the fact that as prices rise, CCP's decline. Due to the increased prices this fall, no CCP's are available to KYJ farms. Additionally, no LDP's are available either. Assuming KYJ is able to sign up for the 2003 Farm Program before Dec 1, 2002 and is able to prove a soybean yield of 28 bushels on 200 soybean base acres,

some residual 2002 payments will be available for receipt. The payment rates are \$.049 for corn, \$.036 for grain sorghum, \$.059 for wheat and the full \$.44 for soybeans. This calculates to \$2,894.91 of 2002 payments for KYJ farms.

Therefore, a cash flow reduction of almost \$27,000 in 2002 compared to 2001 handcuffs KYJ farms. How can KYJ farms make up this shortfall? A few options are available if KYJ cannot meet its obligations from current cash on hand; 1) sell grain – an obvious option given high prices, but the tax implications should not be ignored; 2) borrow funds against its operating loan – an option that may or may not be feasible given KYJ's current financial standing with its lender(s); 3) borrow funds using CCC loans – probably a better alternative than using a traditional operating loan due to lower interest rates or 4) request an advance (50% by Dec 1, 2002) on the scheduled Direct Payment portion of the 2003 Farm Program (no CCP's are scheduled due to relatively high commodity prices) – once again, recognizing the tax implications of this decision.

Perhaps the only silver lining to this cash flow dark cloud is KYJ farms will be confronted with less of a "tax problem" when analyzing its year-end tax strategies.

Job Creation and Worker Assistance Act of 2002
Rush Midkiff

President Bush signed the Job Creation and Worker Assistance Act of 2002 on March 9, 2002. The Act included a tax change that will affect farm clientele.

The Act introduces a special bonus depreciation allowance of 30% for certain property acquired after September 10, 2001 and before September 11, 2004. The property eligible for this new bonus depreciation

must be MACRS property with a recovery period of 20 years or less. Most agricultural production assets other than farm buildings should be able to receive this new bonus depreciation. The bonus depreciation is subtracted from the purchase price and the remainder of the asset is depreciated using normal MACRS depreciation tables. The bonus depreciation deduction applies unless the taxpayer elects out of applying it to any class of property for the tax year that the deduction is available.

The 30% special depreciation allowance is not limited by taxable income or the \$200,000 purchase limitations like the Section 179 expense and is fully allowed for AMT purposes.

To be qualifying property, the property must:

- 1) be purchased after September 10, 2001 and before September 11, 2004.
- 2) be placed in service before January 1, 2005.
- 3) be new property (not used).
- 4) not be required to be depreciated under the Alternative Depreciation System.
- 5) have an Applicable MACRS recovery period of 20 years or less.

If taxpayers **do not want to take the 30% first-year depreciation**, then they *must* attach a statement to their income tax return indicating that they are not claiming the special allowance. The statement should indicate the class of property for which the taxpayer is electing not to claim the 30% special depreciation allowance. This election applies to all assets that fall into the selected class.

The state of Kentucky has not adopted this law; therefore, for 2002 we will have two depreciation schedules; one for IRS and one for Kentucky Revenue Cabinet.

If you have questions, please ask your specialist at your tax planning session.

Young Farmers in the Green River Area

Ross Pruitt, KFBM intern

With the help of Green River Extension Agents for Agriculture, Suzy Martin, and Craig Gibson, a questionnaire was designed to help the Farm Business Specialists and area Agriculture Agents in planning for future programs and understanding the needs of the farmers they serve. This was in conjunction with the Cooperative Extension Service's internship program where each intern must design and complete a project during the internship. Highlights of the survey are listed in the sections below.

Thirty-seven young farmers from the Green River Extension Area (Union, Webster, Henderson, Daviess, McLean, Ohio and Hancock counties) were interviewed. Of these thirty-seven farmers, twenty were members of the Kentucky Farm Business Management Program. The age range of those surveyed was between eighteen and thirty-five with an average age of 26.4 years of age. Of the twenty-one farmers that attended college, Western Kentucky University was most often attended with Murray State University and the University of Kentucky tied for second. Two-thirds of those attending college attained a Bachelor of Science degree in an agriculture related field, with agribusiness or agricultural economics being the most popular degrees attained. Eighty four percent of those interviewed still helped out on the farm regardless of attending college or not.

Another question asked of the respondents was whether or not they foresee any other family members returning to the farming operation. This question revealed that 78% do not foresee additional family members returning to the operation. When those interviewed responded to a question regarding how their return was facilitated, most stated that the planning started prior to graduation from high school. The vast majority (86%) of those surveyed hold ownership interest in the farming operation while only 54% stated that there was a plan to transfer control of the operation. This is interesting to note especially when just over three-fourths of those interviewed had started planning or saving for retirement. Only nineteen of the farmers interviewed (51%) stated that there was expansion to facilitate their return.

Thirty farmers that were interviewed considered themselves full time farmers. When asked if a they or a family member had an off farm job, the results were about even. On average,

73% of each farmer's gross family income is from farming with being paid a salary the most often reported way of receiving income. Eighty-four percent of those interviewed felt that their income was meeting their financial needs. Of those interviewed, all but one had health insurance.

Other questions asked during the survey included how the operation had changed since the return of the young farmer and changes in the business organization if any. These results are available by contacting Suzy Martin. If you receive a copy, it is encouraged to sit down and discuss these questions with your family members.

2002 Annual Meetings

Bluegrass Farm Analysis, Inc.

Thursday, November 21st at the Harrison County Extension Office.

Pennyroyal Farm Analysis, Inc.

Monday, November 25th at the Christian County Extension Office

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