
KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

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Inside:

Tax Planning.....1
Tax Laws.....2
Worm Farming.....6
Grain Marketing.....8

Tax Planning

Colby Blair

It is easy to make the assumption that tax planning just got a lot less necessary this year. With Bonus 30%, Bonus 50% and \$100,000 of I.R.C. Section 179 to throw around why bother with tax planning – right? **WRONG!**

Money and time spent on tax planning, before the end of your tax year, can be a rewarding endeavor. Many farmers have seen outstanding yields, high soybean prices and record cattle prices this year. These additional revenues may pose tax consequences on the proprietor that can be less than ideal. The farm business owner is given many opportunities through the use of pre-paid expenses, accelerated depreciation, income averaging, etc. that, when used effectively, can create a much more manageable income tax liability over time.

There are numerous factors to consider when implementing a tax management strategy. The key should be to eliminate the enormous swings in tax liability each year. A “bad” year followed by a “good” year often causes a farm business owner to go from owing no taxes to owing substantial taxes. Farmers should exert caution and pay close attention to their position in their respective tax bracket. By participating in tax planning they can become aware of the potential of surging into higher tax brackets. This movement can be avoided. If farmers find that they are only \$5,000 into the 28% tax bracket, it may be to their advantage to either pre-pay some expense or pay up the interest on their loans before the year ends and save themselves approximately \$1,400 (28% times \$5,000) in income taxes. By expensing the \$5,000, (money that would be expensed within the next month or so anyway) the farmer has reduced his taxable income by the same amount and remains in the 25% tax bracket.

As always, consult your tax advisor before making any decisions and remember that tax planning is always important. Also, if your tax practitioner advises you to buy a new truck because of the new depreciation rules then my suggestion would be to find yourself a new tax practitioner because you should never be advised to buy something in your business just because of a new tax law. Make investments into

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your business because they are good investments, not because you get a tax break. If you are interested in having a tax estimate done on your farm, contact your KFBM fieldperson. *KFBM believes that better records produce better management.*



2003 Income Tax Newsletter

Craig Gibson

It seems that each year is filled with new income tax laws. Some years do not contain many changes that significantly impact agriculture. Some years have changes that provide an opportunity to significantly impact taxable incomes. It appears the 2003-year is the latter. The Jobs and Growth Tax Reconciliation Act of 2003 impact all individual income tax rates, standard deductions, child tax credits, I.R.C. Section 179 deduction, and first-year additional depreciation.

It is the intent of this newsletter to review some of the tax law changes that influence taxable income for 2003. We will also review changes pertinent to income tax credits. It is important, as always, for readers to understand the difference between “deductions” and “tax credits.” Simply put, deductions (or expenses) reduce taxable income. Tax credits reduce income tax.

Increase in Child Tax Credit. This tax credit has allowed individual taxpayers to claim a credit for each child under the age of 17 and for whom the taxpayer claims a dependency exemption. The 2003 Act increased the credit to \$1,000 per child for 2003 and 2004. Under former tax law, the credit was scheduled to be \$600 per child in 2003. For 2003, the \$400 was paid in advance based upon the information contained in the taxpayer’s 2002 tax return. Thus, the advance payment will reduce the child tax credit that can be claimed on the 2003 tax return to \$600, unless the advance was not received and the taxpayer was entitled.

Standard Deduction. The 2003 Act increases the basic standard deduction for married taxpayers filing a joint return to 200% of the basic standard deduction

for single taxpayers. The increase is applicable for only the 2003 and 2004 tax years. After the 2004 tax year, the relationship of the basic standard deduction reverts to prior tax law. The new law does not affect the basic standard deduction for taxpayers filing as head of household. The following are the basic standard deductions by taxpayer category for 2003.

Standard Deduction for 2003

Single	\$4,750
Married filing jointly	9,500
Married filing separately	4,750
Head of household	7,000

Tax Brackets. The new 2003 law expands the amount of taxable income subject to the 10% tax rate. In 2001, the 10% “bracket” was created for the first \$6,000 of taxable income for single taxpayers and \$12,000 of taxable income for married taxpayers filing jointly. For 2003, the 10% tax bracket applies to the first \$7,000 of taxable income for single taxpayers and \$14,000 of taxable income for married taxpayers filing jointly. For taxpayers with taxable incomes above the respective amounts, this reduces 2003 income taxes by \$50 for single taxpayers and \$100 for married taxpayers filing jointly.

The 2003 Act also reduces the top four regular income tax rates for all taxpayers. Prior to 2001, the top four tax rates were 28%, 31%, 36%, and 39.6%. The 2001 tax law scheduled a gradual reduction of the rates through 2006. The 2003 law accelerates the rate reductions to the following tax rate levels: 25%, 28%, 33%, and 35%.

For married taxpayers filing jointly, the new 2003 law expands the size of the 15% regular income tax bracket for 2003 and 2004. The 15% income tax brackets for various taxpayer filing statuses after the 2003 Act is as follows:

The 15% Income Tax Bracket Taxable Income Levels

	Income begins at	Income Up to
Single	\$7,001	\$28,400
Married Filing Joint	14,001	56,800
Married Filing Separate	7,001	28,400
Head of Household	10,001	38,050

Individual Capital Gains Rates Are Reduced.

Under the 2001 Act, long-term capital gains were taxed at the lesser of the taxpayer's ordinary income or one of several capital gains rates that ranged from 8% to 28%. The applicable capital gains rate depended upon the taxpayer's regular income tax bracket and whether the asset was held for more than five years with the holding period beginning after December 31, 2000.

The 2003 Act reduces the maximum capital gains tax to 15% for gains realized after May 5, 2003 and before January 1, 2009. The "old rates" apply to gain realized before May 6, 2003. For taxpayers who have taxable income within the 10 or 15 percent tax brackets, the new capital gains tax rate is 5%, but 10% for gains realized before May 6, 2003. The new law makes no provisions for any difference in the capital gains tax rate if the holding period is five years or longer.

Income Tax Rates on Dividends. Prior law caused dividend income to be taxed at rates as determined by taxable income levels. The 2003 law provides that dividends will be taxed at the same rate that applies to capital gains, effective for tax years from 2003 through 2008. Therefore, qualifying dividend income will be taxed at a maximum tax rate of 15% and may be taxed at 5% if the taxpayer's tax bracket is 10 or 15 percent.

Alternative Minimum Tax (AMT.) AMT is the amount by which the tentative minimum tax exceeds the regular income tax. A calculation, separate from the regular tax computation, is made whereby certain adjustments for tax preference items in determining AMT.

The AMT exemption amounts will increase for tax years 2003 through 2004 to \$58,000 for joint filers and surviving spouses, and to \$40,250 for other individual taxpayers. However, the increase in the AMT exemption amount ceases to apply in tax years beginning in 2005 or later.

Special Depreciation Allowance for Certain Property. The Job Creation and Worker Assistance Act of 2002 allows an additional 30% depreciation deduction for qualified **new** property placed into service after September 10, 2001 and before January 1, 2005. The class life of qualified property must be 20 years or less. Property used by any person before September 11, 2001 is not qualified property. The

deduction is applied on all property within a class life category and not on an individual asset basis.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 allows an additional 50% depreciation deduction for qualified **new** property placed into service (purchased) after May 5, 2003 and before January 1, 2005. Qualified property definitions for the 50% depreciation are the same as those for the 30% depreciation deduction, which do include **new** farm buildings such as tool sheds, machinery storage buildings, and tobacco barns. In addition, the deduction is applied on all property within a class life and not on an individual asset basis.

Taxpayers can "elect out" of both additional first-year depreciation provisions. It is assumed that the additional depreciation is taken unless the election to forego is made as prescribed by income tax return instructions. With the new law, taxpayers may "choose" which additional first-year depreciation provision to use. This provides immense flexibility in tax planning. However, flexibility can create pitfalls if the taxpayer fails to fully understand the new laws.

To more fully understand the consequences of the first-year additional depreciation, we will look at the following example. Let's assume the following:

Income Before Depreciation	\$ 70,000
Depreciation from prior years purchases	20,000
5-year class life purchases	0
7-year class life purchases (after 05/05/03)	120,000
Remaining cost of assets traded	0

There are three possibilities in calculating 2003 depreciation expenses. These possibilities result in different levels of net farm income.

Net Income without additional depreciation:

Income before depreciation	\$70,000
Depreciation from prior years purchases	20,000
Depreciation from 2003 purchases (150% MACRS)	12,857
Net Farm Income	<u>\$37,143</u>

Net Income with 30% additional depreciation:	
Income before depreciation	\$70,000
Depreciation from prior years purchases	20,000
Depreciation from 30% additional depreciation	36,000
Depreciation from 2003 purchases (150% MACRS)	9,000
Net Farm Income	\$5,000

Net Income with 50% additional depreciation:	
Income before depreciation	\$70,000
Depreciation from prior years purchases	20,000
Depreciation from 50% additional depreciation	60,000
Depreciation from 2003 purchases (150% MACRS)	6,429
Net Farm Income	\$-16,429

The remaining cost of items traded is also eligible for the 30% or 50% bonus depreciation. So, even if there was a relatively small amount of “boot” paid in a trade, but a large amount of remaining cost in the item traded (as would be the case in trading a one year old combine), using the 30% or 50% additional depreciation could still result in a large depreciation deduction. Depending upon a taxpayer’s situation, this may or may not be “good.”

It hopefully becomes quite evident that net farm income can change dramatically dependent upon the magnitude of capital purchases within a certain class life, when they were purchased, and whether the 30% or 50% additional depreciation is used. In the above example, if the \$37,143 net farm income is too high, but the \$5,000 net farm income is too low, the additional depreciation is not an effective tool to manage income tax liability. In addition, if the additional depreciation is used in the year of purchase, depreciation amounts in future years are lower than if not taken. This creates the dilemma of large income taxes due and no cash that many face when loans are used to finance capital purchases.

The second dilemma in this provision is that Kentucky does not recognize this deduction. Therefore, if this deduction is used for Federal purposes, an adjustment is made on the Kentucky return, thus resulting in a “larger” Kentucky income tax.

I.R.C. Section 179. This deduction allows taxpayers to deduct the cost of certain business assets in the

year purchased. The 2003 Act increases the maximum annual dollar amount that can be deducted to \$100,000 for property placed in service during the 2003, 2004, and 2005 tax years. In 2006, the maximum annual dollar amount reverts back to \$25,000.

The \$100,000 deduction limit is reduced by the amount by which the cost of all qualifying property placed in service during the tax year exceeds \$400,000. In 2006, the deduction limit is reduced when the cost of all qualifying property placed in service during the tax year exceeds \$200,000.

This deduction is much more effective in income tax management in that the dollar amount deduction is optional. The dollar amount is selected on an item-by-item basis. Used property qualifies. However, farm buildings (i.e., tool sheds, tobacco barns, etc.) do not.

Kentucky does not recognize this new change. The maximum annual dollar amount that can be deducted is \$25,000 on the Kentucky tax return. The deduction limit is reduced when the cost of all qualifying property placed in service during the tax year exceeds \$200,000.

Other Income Tax Issues

It seems that the experts annually bring certain tax issues forth. This year is no exception. Although these issues are not necessarily directly related to the 2003 tax legislation, they do have relevance to taxpayers and are noted in the following.

The Dependent Care Credit, where a tax credit is given based on employment-related expenses, is changed for tax years beginning after 2002. The maximum percentage credit is increased from 30 percent to 35. The maximum amount of eligible employment-related expenses is increased from \$2,400 to \$3,000 if there is one qualifying child or dependent, and from \$4,800 to \$6,000 if there are two or more. The income threshold for reduction of the credit is increased to \$15,000 from \$10,000. For taxpayers with an adjusted gross income more than \$43,000, the credit percentage is limited to 20 percent.

Income Averaging was made available to farmers for the 1998 tax year. Initially, the averaging calculations did not allow negative taxable income in base years (i.e., the three years prior to the tax year

being averaged). New interpretation now allows negative taxable income in the base years. Therefore, any farmer that had negative taxable income in base years may wish to amend the income tax return(s) affected by the new interpretation. Amended returns can be filed for 1998, 1999, and 2000. Farmers may look for a Schedule J in their income tax return to see if income averaging was used in any of the three preceding tax years.

Individual Retirement Accounts (IRAs). The maximum amount of tax-favored contributions to IRAs will gradually increase from the current \$2,000 limit to \$5,000 in 2008, and will then be adjusted for inflation. Individuals who have attained age 50 will be permitted to make additional “catch up” contributions to their IRAs. The following shows the maximum dollar contribution limits for tax years beginning in 2003 and after.

For tax years	Contribution limits for taxpayers:	
	Age 50 & Over	Under 50
2003	\$3,500	\$3,000
2004	3,500	3,000
2005	4,500	4,000
2006	5,000	4,000
2007	5,000	4,000
2008 and after	6,000	5,000

Other limitations related to IRAs that have not changed, but are significant, include: Individuals can only make contributions to an IRA if they have earned income. Contribution limits are the lesser of earned income or the amounts showed above. Deductible traditional IRA contributions continue to be limited when individuals are active participants in an employer-sponsored retirement plan. The contribution to a Roth IRA is limited for single individuals where the adjusted gross income is greater than \$95,000 (with the full phase-out occurring at \$110,000). For married individuals filing a joint return, the adjusted gross income threshold is \$150,000 (with the full phase-out occurring at \$160,000).

Pension Contributions. The 2001 Act increases the dollar limits on certain retirement and income deferral plans. In addition, for individuals who are at least age 50 before the end of the plan year, the current dollar limits on elective deferrals are increased for Code Sec. 401(k) qualified cash or deferred arrangement plans, Code Sec. 408(p) tax-sheltered annuities, Code Sec. 408(k) SEPs, Code

Sec. 408(b) SIMPLEs, and certain other elective deferrals.

Tax Credit for Elective Deferrals and IRA Contributions. To encourage low- and middle-income taxpayers to establish or maintain private savings accounts for retirement, a temporary non-refundable tax credit for contributions or deferrals to retirement savings plans is established. This credit is in addition to the dollar amount exclusion from gross income in calculating income tax. The maximum credit is 50 percent of the savings contribution to a qualified retirement savings plan (not to exceed \$2,000 in contribution or a \$1,000 credit). To attain the maximum credit, adjusted gross incomes must be less than or equal to \$30,000 (joint returns), \$22,500 (head of household), or \$15,000 (all other cases). The credit decreases as adjusted gross incomes become greater. There is no credit when adjusted gross incomes equal \$50,000 (joint returns), \$37,500 (head of household), or \$25,000 (all other cases). To be eligible, the taxpayer must be 18 years of age and is not claimed as a dependent on another income tax return. Provisions become available in tax years after 2001 and expire in tax years after December 31, 2006.

Education IRAs. The limit on maximum annual contributions to an education IRA increases from \$500 to \$2,000 after 2001. The modified adjusted gross income level for married couples filing jointly and income phase-outs for married contributors increase to twice the amounts applicable to single taxpayers. The category of expenses that they can pay with tax-free earnings from education IRAs is expanded to include elementary and secondary education costs, whether incurred in public, private, or religious schools.

Deduction for Higher Education Expenses. A new deduction for qualified tuition and related expenses is available to individuals in tax years beginning after December 31, 2001 and until December 31, 2005. In 2003, the deduction for qualified educational expenses is limited to \$3,000 and is available to taxpayers with adjusted gross incomes less than \$65,000 (or \$130,000 for married taxpayers filing jointly). In 2004 and 2005, the deduction is limited to \$4,000 for individuals with an adjusted gross income of less than \$65,000 (or \$130,000 for married taxpayers filing jointly) or \$2,000 for individuals with an adjusted gross income more than \$65,000 (or \$130,000) and less than \$80,000 (or \$160,000 for married taxpayers filing jointly). This deduction is

not allowed if the Hope Scholarship Credit or Lifetime Learning Credit is used with the qualified educational expenses.

Prepaid Expenses: Change of plans. Farmers are allowed to deduct the cost of supplies even if the supplies are used in the following tax year. But two sets of rules must be met. These rules are familiar to most producers and are as follows:

Rule 1:

The expenditure must be a payment for the supply rather than a deposit

The prepayment must be made for a business purpose and not tax avoidance

The deduction must not result in a material distortion of income

Rule 2:

Prepaid expenses shall not exceed 50% of deductible expenses other than the prepaid expenses unless the taxpayer is a “qualified farm-related taxpayer.”

A change of plans may create the situation whereby the purchased supplies are not used and a credit balance results with the vendor from whom the supplies were purchased. In the situation that the vendor reimburses the credit balance, careful documentation is necessary to show that the vendor is reimbursing a credit balance that represents an unused quantity at the same per unit price as originally paid. Failure to document such suggests a reimbursement of a “deposit.” Deposits to a vendor are not the same as the purchase of supplies and risk being disallowed as a deduction in the year the deposit is made.

Promissory Notes to Suppliers. A farmer that pays for farm inputs by giving the vendor a promissory note cannot claim a deduction for the inputs. Instead, the deduction is allowed in the tax year the promissory note is paid. In contrast, if farm inputs are paid with loan proceeds from a third party, the deduction for the inputs is allowed in the tax year the inputs are paid. A lending subsidiary of the vendor from whom farm inputs is purchased may not be considered a “third party” in the eyes of Internal Revenue Service.

In year-end tax planning, farmers must take special care in the last two items mentioned. Cash basis farmers are able to effectively “plan” their tax liabilities. However, it must be done properly! Over

drawing accounts in paying year-end expenses is a no, no.

Although we barely touched the surface with the given information, we hope that this information is of benefit. We must count our blessings for the bountiful 2003-year. After-tax dollars are important to a viable business. Please feel free to contact your KFBM specialist with questions about this newsletter or other farm management issues that relate to the management of your farm business. In addition, please have a Merry Christmas and Happy and Productive New Year!

Worm Farmers

Colby Blair

Let’s address the situation where a producer purchased some worms in 2002 with the intent to raise them and sell pounds of worms the next year. Lo and behold, the person to whom you had intended to sell them is no longer allowed to operate in the state of Kentucky and you still have a lot of worms. In analyzing this scenario, there are many factors that must be considered to determine how the Internal Revenue Service will require you to report the cost of the worms.

There are basically three forks in the road as it pertains to the tax treatment of worms.

1. Are the worms breeding stock subject to I.R.C. Section 1231 treatment?
2. Are the worms livestock held for resale subject to deducting the cost only in the year sold and, likewise, included in self-employment income?
3. Is the issue not worm related at all and has the farmer merely purchased a security or contract?

In addressing the first two possibilities we must ascertain whether or not the circumstances represent a breeding operation or a fattening/feeding operation. The IRS defines a breeder operation as one that “will generally begin with the purchase of animals proven to be able to reproduce”. A fattening/feeder operation is defined as one in which “young or mid-maturity animals are purchased to feed up to the next level of maturity or for slaughter”.

The special definition that is used in the case of livestock is found in IRC section 1231(b)(3) which

defines "property used in the trade or business" as including "(A) cattle and horses, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him for 24 months or more from the date of acquisition, and (B) other livestock, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry. "

Treas. Reg. section 1.1231-2(a) states: "(3) For the purposes of section 1231, the term 'livestock' is given a broad, rather than a narrow, interpretation and includes cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals, and other mammals. However, it does not include poultry, chickens, turkeys, pigeons, geese, other birds, fish, frogs, reptiles, etc." A search through the animal kingdom will tell you that a worm is an invertebrate and belongs to the phyla annelida. It is not a mammal nor does it bear fur. So, at first glance, a worm cannot be I.R.C. Section 1231 property. However, a worm is not a reptile and it's hard to tell if it is an "etc." ☺. Aside from all of the Internal Revenue Code jargon, there is an argument to be made that the worms were purchased with the intent to breed and therefore the offspring sold each year would be treated the same as raised calves sold and the initial stock would be depreciated over some life, possibly 3 or 5 years.

Only livestock (property) "used in the trade or business" qualifies for IRC section 1231 handling. Any animals purchased for resale must be included in inventory and its cost is recovered at the time of sale. The classification of income as Schedule F or IRC section 1231 affects the computation of self-employment tax.

Chapter 11 of Publication 225, *Farmer's Tax Guide*, contains a discussion of various types of dispositions. The following represents a basic indication of reporting requirements for certain types of sales.

Class of Animal	Type of Asset	Sale Reporting
Purchased for breeding	Depreciable when placed in service, IRC section 1231 property	Form 4797 -- asset used in trade or business

Offspring raised for breeding purposes	IRC section 1231 property generally zero basis	Schedule D -- before placed in service, Form 4797
Offspring raised for sale as breeder	Ordinary income asset	Schedule F -- sale of raised animals
Offspring sold as cull	IRC section 1231 property	Form 4797
Young animal purchased to feed to mid-maturity	Ordinary income	Schedule F -- sale of animal purchased for resale
Animal purchased to feed to final slaughter	Ordinary income asset	Schedule F -- sale of animal purchased for resale

There may be exceptions to some of the examples in the preceding table and worms appear to be a possibility. Whether livestock is held for draft, breeding, dairy, or sporting purposes depends on all the facts and circumstances in each case. See Treas. Reg. section 1.1231-2(b)(1).

If we play the "devil's advocate" here it could be argued that, instead of buying worms, the farmer merely bought a contract. Farmers did, in fact, pay nearly \$100 per pound for the worms, which far exceeded the \$5 per pound that the large waste management operation might have paid. That contract is now worthless and could be treated the same as if the taxpayer had bought stock that is now worthless. If you own securities and they become totally worthless, you can take a deduction for a loss. Stocks, stock rights and bonds (other than those held for sale by a securities dealer) that became worthless during the tax year are treated as though they were sold on the last day of the tax year. This affects whether your loss is long-term or short-term. Report worthless securities on line 1 or line 8 of the Schedule D, whichever applies. In columns (c) and (d), write "Worthless."

The best advice that we can offer is to talk with your tax practitioner. An argument could be made in support of each of the three methods (I.R.C. Section 1231 property, Ordinary Income Asset or Worthless Investment) discussed in this article, but an argument could be made against each method as well.



West Kentucky Grain Marketing Project

November 24, 2003

Steve Riggins

Commodity markets have produced some exciting price action and some challenging marketing decision making over the past 100 days. Soybean prices have risen from the mid- \$5.00 range to over \$8.00 before falling back to around \$7.50, while wheat prices staged a strong recovery from harvest lows to then soften somewhat before rising recently to news highs (well above \$4.00) only to decline over the past few days to around \$3.85-\$3.95 per bushel. By comparison corn prices have been well behaved, increasing roughly 30 cents from harvest lows of around \$2.12-\$2.15. The lows occurred by mid-October in most locations around the State and provided only brief opportunities for very modest loan deficiency payments (LDP's). Corn prices probably made a stronger and quicker recovery from harvest season lows than many analysts, grain merchants or farmers anticipated. Where to from here? That is the question on many farmers' minds. Perhaps a more searching question is what marketing plan to utilize for any remaining old-crop, i.e. 2003 harvest, and what marketing plan should be devised for an initial plan of action for the new-crop, 2004 expected production.

Price action in the corn market has probably been relatively stable compared to wheat and especially soybeans due to the fundamental supply and demand picture for corn. It now looks like U.S. farmers have harvested the largest corn crop in history at 10.278 billion bushels with a record average yield of 143.2 bu/acre. The old record yield of 138.6 was set in 1994, the only other year on record of a U.S. corn crop in excess of 10 billion bushels. The nine-year span between record corn yields is the longest in modern history.

This record harvest is expected to allow for record use of corn with total use for all purposes exceeding 10 billion bushels for the first time ever. Record use is forecast due to expectations of yet another record setting pace of corn used in the food/industrial uses category. The primary driver is expected to be corn

used to produce ethanol. The only time in the past 30 years when use in this category has not increased on a year-to-year basis was the 1995-96 marketing season when corn prices went to all-time highs of more than \$5.00/bushel and some food corn processing and ethanol facilities were shut down.

Corn used as animal feed, by far the biggest use category accounting for 55-60 percent of total use in most years, is also expected to recover somewhat from last year's slightly reduced level. Consumer demand for meat remains robust and poultry and hog producers are responding to record high cattle prices that are expected to lead to increases in the consumption of pork and chicken as the cost of beef rises to consumers. Current record high cattle prices will make it difficult for beef producers to increase beef production very much compared to last year's reduced output as cattle are being slaughtered at lighter weights in order to capture current record prices. It takes a lot of hogs and chickens to equal one steer on full-feed. Therefore, USDA is currently forecasting a very modest increase in corn used for feed of only 1 percent above last season's number.

Even though U.S. corn exports are now the smallest use category on the corn balance sheet accounting for less than 20 percent of forecast total use, this category remains very important in the price determination process. Currently, USDA is projecting U.S. corn exports to be up by nearly 18 percent over year ago totals. Nearly 3 months into the 2003-04 marketing year sales of U.S. corn for export are up 25 percent over last season. However, sales don't always turn into shipments and current actual export inspection data reveals that weekly exports are frequently below the level needed to ultimately reach the USDA's forecast of 1.875 billion bushels.

Weekly corn export sales and export inspections will be an important determinate of the seasonal price pattern between now and planting season for the 2004 corn crop. Market bulls believe that China will significantly reduce corn sales this year and this factor in combination with the large reduction in feed-grade quality wheat from Russia and Ukraine will allow the U.S. to gain market share in the world corn market.

Farmers need to track these weekly export numbers and they need to be ready for the first grain stocks report by USDA in January. On January 12, 2004 USDA will provide the final crop production number and the stocks report. These reports in combination

with a survey of commercial corn processors will be used to assess the rate of corn disappearance during the September, October, November -- 1st Quarter.

Even though corn production and use are both record large corn stocks are projected to increase from last year's modest level of 1.09 billion bushels to a more comfortable 1.35 billion bushels. Why then have corn prices made such an early season recovery?

The bull market argument centers on very tight world stocks relative to world use rates for both corn and wheat. World production, consumption and carryover stock numbers have always been highly suspect in terms of accuracy. Some market analysts have been talking about shrinking world stocks of corn and wheat for at least the past two years and no one seemed to care. It appears the very short U.S. soybean crop, the very large purchases of U.S. soybeans by China and the subsequent high prices this produced finally got everyone's attention. Will the bull market continue? Will we see \$5.00 plus wheat and \$9.00 plus soybeans? Will corn yet set new highs?

In addition to the grain stocks and final production reports, USDA will also publish on January 12, 2004 the Winter Wheat Seedings Report. This report should show a significant increase in winter wheat acres in the U.S. Wheat is produced on every continent on the earth except Antarctica. The world's wheat producers should make a quick response to current strong wheat prices.

South America is currently about 60 percent done planting what USDA has forecast as a 3.6 billion bushel soybean crop. The expected South American soybean crop plus the very small 2003 U.S crop of 2.45 billion bushels still add to more than 6 billion bushels of soybeans. One year ago, combined U.S., Brazilian and Argentine soybean production was slightly below 6 billion bushels. World soybean and world oilseed production are record large and world soybean ending stocks are projected to be only fractionally below last year's record ending stocks.

On the supply side, soybean production prospects in South America will be crucial to price action from now until late February. The condition of wheat in the Northern Hemisphere will also bear watching and corn production in Brazil is also important.

On the demand side, what China does about their corn exports and what they do about additional

soybean purchases (U.S. vs. South America) will be paramount to price determination. A bull market will require continued strong weekly exports of U.S. produced corn, wheat and soybeans. Currently, U.S. wheat exports are slightly ahead of the pace needed to hit USDA's projection for total annual exports. U.S. soybean weekly export sales are at an astounding level relative to the projected total annual soybean export projection and actual export inspections are slightly ahead of last year's pace even though USDA projects annual exports to be down 15 percent over year ago totals (you can't ship what you don't have).

The market bears believe that China will continue to sell corn and they will soon switch their soybean purchases to South America. They also believe production will respond to higher prices and supplies will increase next year.

This era of tight world stocks relative to use and not a lot of opportunity for increased land in crop production in the U.S., especially for corn or soybeans, provides a perfect opportunity for market volatility. This seems well suited for the use of minimum pricing tools as a major portion of any marketing plan. Don't use this year's soybean pricing experience as an excuse to going back to the strategy of doing nothing but trusting to luck. Good marketing plans take time to develop, they always have to be modified, and they involve costs and tradeoffs. That is why it is called risk management.

Have a safe and happy holiday season!



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