FARMERS *for* TAX FAIRNESS™

February 6, 2017

U.S. House Committee on Ways and Means
Representative Kevin Brady, Chairman
Representative Richard Neal, Ranking Member
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal,

We are writing today to express our strong opposition to any tax reform proposals that would limit the ability of agricultural businesses to use the cash method of accounting. Cash accounting is critical to the management of agricultural businesses facing high volatility of commodity prices and input costs.

Farmers for Tax Fairness is a nationwide coalition of farmers, agricultural businesses, and agricultural organizations (www.FairFarmTax.com). We are committed to ensuring that Congress maintains the flexibility in the tax code necessary for farmers to manage their businesses during periods of high commodity and input price volatility. As you prepare legislation to effect comprehensive reform of the tax code, we urge you to not restrict the ability of agricultural businesses to use the cash method of accounting.

Discussion Draft Restricts the Use of Cash Accounting by U.S. Agriculture
On March 12, 2013, the U.S. House of Representatives Committee on Ways and Means issued a discussion draft of provisions to reform the taxation of small businesses. Section 212 of the discussion draft proposed limitations on the use of the cash method of accounting for farmers with gross receipts of more than $10 million. This section would affect farming operations structured as partnerships and as S-corporations. Section 213 of the discussion draft proposed to repeal certain requirements for the use of accrual accounting by C-corporations and to increase the number of family corporations that would be required to use the accrual method of accounting.

When this discussion draft was released, farmers across America objected to the proposal that would seriously impact cash flows and limit their ability to respond to price volatility. In response to this proposal, Farmers for Tax Fairness commissioned a national economic study that revealed that the proposal would remove almost $12.1 billion in equity and borrowing ability from U.S. agriculture. The ripple effects of this impact would be felt far and wide—with some agricultural operations forced out of business and others forced to put off purchasing necessary equipment and inputs. In response to the national opposition against this proposal, Representative Camp, the Chair of the House Ways and Means Committee exempted farming businesses from this proposed change when he introduced the Tax Reform Act of 2014.

Expected Impact on U.S. Agriculture

There are many reasons why Congress should preserve the ability of agricultural businesses to use cash accounting. The cash method of accounting presents simpler recordkeeping for most farmers and provides agricultural operators with significant flexibility to manage their farming operations consistent with their cash flow. By contrast, under accrual accounting, a farmer could incur a significant tax liability even though they have not yet received payment for a product.

As you know, commodity and input price volatility may dramatically affect the profitability of farming and other agricultural operations from year to year. Cash accounting methods allow operations to compensate for price volatility and create greater financial stability for their businesses. Because of this, the vast majority of agricultural businesses use a cash method of accounting.

Many of the farms and ranches that would be affected by this change are third-generation family operations being run by a parent and child or by siblings whose parents or grandparents founded the business. Many of these family operations support dozens of employees but run at very thin margins and with very low net income.

The combination of historically thin margins, rising costs of production, and price volatility can dramatically impact the gross receipts that an entity engaged in farming may have from year to year and may not reflect the actual income or loss reported by the entity. As a result, if Congress were to establish a gross-receipts threshold for the use of cash accounting, an entity may be pushed into the accrual method of accounting because of a year or two of unusually high prices. Note that for an operation such as a feedlot, there is no correlation between an increase in gross receipts from high corn prices and an increase in profits. To the contrary, in a time of rising commodity prices, an increase in gross receipts could narrow margins and reduce profitability.

Under a cash-basis system, a farmer can sell products or pay for inputs based on their cash flow. This cash flow is then reflected in the income or loss that they report. Under the accrual method, income or losses are not related to the actual cash flow of the farmer and may vary dramatically. If farmers are required to use the accrual method, significantly more time and costs will be expended on record keeping and filing claims to carry operating losses back or forward.

The profit margin in agriculture is not large enough to be subject to a gross receipts test. Where other industries may experience a 40% to 50% gross margin to cover operating costs, agriculture usually has gross profit margins under 20% and, in many operations, typical margins may be just 4% to 5%. As a result, many agricultural operations have significant gross sales to generate a modest profit.

A final point that should be noted in this discussion is that increasing the use of accrual accounting in agriculture may actually lead to increased tax complexity rather than simplification. Under an accrual method of accounting, farming operations will increasingly be forced to file amended returns to offset gains from prior years with losses incurred in subsequent years. This constant refiling of tax returns is mitigated to a considerable degree by the use of cash accounting.

Conclusion

We are pleased that the tax blueprint released by the House Ways and Means Committee on June 24, 2016 does not propose to limit the use of cash accounting by agricultural businesses. Nonetheless, we remain very concerned that Congress will seek to raise revenue to support rate reductions by restricting cash accounting. Please know that we are strongly opposed to such proposals and the negative impact they would have on agricultural businesses.

On behalf of the thousands of farmers and agricultural businesses represented by Farmers for Tax Fairness, we appreciate your consideration of this important matter.

Sincerely,

Brian Kuehl, Director
Farmers for Tax Fairness

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