NATIONAL CATTLEMEN'S BEEF ASSOCIATION
1301 Pennsylvania Ave., NW, Suite #300 • Washington, DC 20004 • 202-347-0228 • Fax 202-638-0607

April 15, 2015

The Honorable Chuck Grassley
Co-Chair, Individual Income Tax
Committee on Finance
United States Senate
219 Dirksen Senate Office Bldg.
Washington, DC 20510

The Honorable Debbie Stabenow
Co-Chair, Individual Income Tax
Committee on Finance
United States Senate
219 Dirksen Senate Office Bldg.
Washington, DC 20510

The Honorable John Thune
Co-Chair, Business Income Tax
Committee on Finance
United States Senate
219 Dirksen Senate Office Bldg.
Washington, DC 20510

The Honorable Benjamin Cardin
Co-Chair, Business Income Tax
Committee on Finance
United States Senate
219 Dirksen Senate Office Bldg.
Washington, DC 20510

The Honorable Mike Crapo
Co-Chair, Savings & Investment
Committee on Finance
United States Senate
219 Dirksen Senate Office Bldg.
Washington, DC 20510

The Honorable Sherrod Brown
Co-Chair, Savings & Investment
Committee on Finance
United States Senate
219 Dirksen Senate Office Bldg.
Washington, DC 20510

Dear Senators Grassley, Thune, Crapo, Stabenow, Cardin, and Brown:

The National Cattlemen's Beef Association (NCBA) has represented America's cattlemen and women since 1898, preserving the heritage and strength of the industry through education and public policy. As the largest and oldest national association of cattle producers, NCBA represents a very diverse beef industry that strives to meet demand in emerging markets and increase demand for beef. On behalf of NCBA, I commend the Senate Finance Committee for embarking on its thoughtful approach to tax reform, and I would like to submit the following comments for your consideration. NCBA is a supporter of the concept of tax reform because the beef industry, like the agriculture industry in general, needs a simplified pro-growth tax code that will encourage the current generation and future generations of family-owned operations to stay in business. It is our goal to provide you with guidance as to how the following provisions impact the beef industry. NCBA stands ready to assist you with any questions you may have regarding the beef industry and the impact of the tax code on the livelihood of America's ranching families.

<u>The Estate Tax and Section 2032(A) Special Use Valuation</u>
NCBA is very appreciative of the significant and permanent estate tax relief that was passed as part of the American Taxpayer Relief Act of 2012. As you may know, most farmers and ranchers are asset-rich and cash-poor, with most of their wealth tied up in the ever-increasing value of the land they use to grow

food and fiber for consumers around the world. Unfortunately, the appraised value of rural land is inflated when compared to its agricultural value—and short of full repeal of the estate tax, Congress should maximize relief efforts for farmers and ranchers through expanding thresholds in sections of the tax code. Even though Section 2032A special use valuation can be used by some agricultural operations to protect them from the devastating impact of estate taxes, an expansion of Section 2032A special use valuation beyond its current $1 million limitation would expand the exemption to cover more farm and ranch families who are willing to make a long-term commitment to their businesses. We recommend that there be no limitation on the amount that property values can be reduced to reflect use valuation for estate tax purposes under Section 2032A.

Cash Accounting vs. Accrual Accounting

In the previous Congress, there was discussion involving a fundamental change to the agriculture industry--requiring agricultural businesses with more than $10 million in gross receipts to shift from the cash accounting method to the accrual method of accounting. This proposal was met with fierce opposition because cash accounting is a common practice in most agricultural businesses. Due to uncertain and fluctuating income that results from variable cropping practices, weather conditions, and markets, farmers and ranchers need a tax code that allows them to manage the risks associated with agriculture while complying with tax liabilities under the law. Cash accounting combined with the ability to accelerate expenses and defer income gives farmers and ranchers the flexibility they need to manage their tax burden. Requiring agricultural businesses to shift to accrual accounting could dramatically reduce working capital and equity available for investment in many sectors of the agriculture industry as well as increase complexity and decrease flexibility for many agricultural businesses.

The following example, taken from the Farmers Tax Guide published by the IRS (IRS Publication 225) illustrates the differences between the two accounting methods:

Example 1.

You are a farmer who uses an accrual method of accounting. You keep your books on the calendar year basis. You sell grain in December 2013 but you are not paid until January 2014. Because the accrual method was used and 2013 was the tax year in which the grain was sold, you must both include the sales proceeds and deduct the costs incurred in producing the grain on your 2013 tax return.

Example 2.

Assume the same facts as in Example 1 except that you use the cash method and there was no constructive receipt of the sales proceeds in 2013. Under this method, you include the sales proceeds in income for 2014, the year you receive payment. Deduct the costs of producing the grain in the year you pay for them.

NCBA can provide additional real-world examples of the myriad challenges this proposal poses for agriculture. Simply put, we do not believe that this change is appropriate in a commodity industry with high price volatility, low margins, high capital needs, and low liquidity. Mandates to use accrual basis accounting will pose significant tax liability and eliminate the flexibility agricultural operations need to adjust to ever-changing environmental, regulatory, and market conditions. We strongly oppose such mandates.

Also, NCBA is concerned about the unknown ramifications of requiring more beef operations to use accrual accounting instead of cash accounting. For instance, are you aware that cash accounting is a pre-requisite for a rancher to take advantage of disaster relief found in the tax code?

For example, if a producer is forced to sell livestock, in excess of normal levels, due to shortages of water, feed or other consequences of drought, the income tax on the gain from the sale of those animals may be postponed. Producers have two distinct tax options available to them in this circumstance:

1. Code Section 451(e): The election to postpone reporting the taxable gain on the additional sales of any livestock for one year; or

2. Code Section 1033(e): The election to postpone, and altogether avoid, paying taxes on the gain from the sale of breeding, draft, or dairy animals if they are replaced within a specified time frame.

IRC Section 451(e) provides for the one-year postponement of gain on the sale of all classes of livestock. In order to qualify for this election a producer must meet the following criteria:

- Their principal business must be farming.
- <u>They must use the cash method of accounting</u>.
- They can show that under usual business practices, they would not have sold or exchanged the additional animals this year except for the weather-related condition.
- The weather-related condition caused an area to be designated as eligible for assistance by the federal government.

As you may know, the U.S. beef industry currently has the smallest herd since the 1950s. Long-term drought, fires and floods have played a major role in the liquidation of our herd. To top it off, the beef industry is not subsidized by taxpayers and we do not have a government-backed insurance program—and we do not want either of them. The tax code is one of the few areas where ranching families and beef operations can seek temporary relief from disasters. We ask that you carefully consider the ramifications of requiring more and more ranching families to switch from cash accounting to accrual accounting.

<u>Section 179 Expensing and Bonus Depreciation</u>

As you may know, agriculture requires large investments in machinery, equipment and other depreciable assets and because of this farmers and ranchers place great value on tax code provisions such as Section 179 small business expensing and bonus depreciation. Section 179 allows producers to write off capital expenditures in the year that purchases are made rather than depreciate them over time. The ability to immediately expense capital purchases also provides an incentive for farmers and ranchers to invest in their businesses and offers the benefit of reducing the record keeping burden associated with the depreciation.

Section 179 small business expensing provides agricultural producers with a way to maximize business purchases in years when they have positive cash flow. Under the expired law the maximum amount that a small business can immediately expense when purchasing business assets instead of depreciating them over time is $25,000 adjusted for inflation. We strongly encourage you to restore the maximum amount of expensing under Section 179 to $500,000 indexed for inflation as it was previously set for 2014. We are concerned that the failure to make permanent Section 179 expensing and bonus depreciation will place additional burdens on farm and ranch businesses who operate with tight profit margins and already face an unpredictable tax code.

Section 1031 Like-Kind Exchange

According to the Internal Revenue Service, whenever you sell business or investment property and you have a gain, you generally have to pay tax on the gain at the time of sale. IRC Section 1031 provides an exception and allows you to postpone paying tax on the gain if you reinvest the proceeds in similar property as part of a qualifying like-kind exchange. Gain deferred in a like-kind exchange under IRC Section 1031 is tax-deferred, but it is not tax-free. The exchange can include like-kind property exclusively or it can include like-kind property along with cash, liabilities and property that are not like-kind. If you receive cash, relief from debt, or property that is not like-kind, however, you may trigger some taxable gain in the year of the exchange.

There can be both deferred and recognized gain in the same transaction when a taxpayer exchanges for like-kind property of lesser value.

NCBA opposes calls for the repeal of 1031 like-kind exchange rules. By removing like-kind exchanges from the tax code you will significantly limit the ability of farmers and ranchers, of which many are asset-rich and cash poor, to use the tax code to keep their family-owned assets from being swallowed up by land developers.

Without question, the increased demand in the agricultural and production real estate markets and the increased demand this has placed on title companies, surveyors, and appraisers, has placed a tremendous burden on individuals and companies that are utilizing this law for tax deferment when selling family ranches and businesses. Instead of repealing like-kind exchange rules, you should consider modifying them to make like-kind exchanges more beneficial to farmers and ranchers.

NCBA supports change of the current IRC section 1031 g (1) to generally provide:

"A taxpayer selling farm, ranch, or other agricultural production property shall have 180 days (rather than the current 45 day limit) to identify a maximum of six replacement properties (rather than the current number of three) regardless of value to be received in exchange as "like kind" after the date on which the taxpayer transfers the relinquished property in the exchange, and such property is received not more than 365 days (rather than the current 180 day limit) after the date on which the taxpayer transfers the property relinquished in the exchange, regardless of the taxable year in which the transfer of the relinquished property occurs."

Conservation Easement Tax Incentive

On January 1, 2015, an important tax incentive expired for landowners who voluntarily choose to permanently preserve their land as undeveloped open space and working farm or ranch land.

NCBA requests Congress make permanent the enhanced deductibility of eligible donated conservation easements.

These provisions include:

- An increase in the deduction a landowner can take for donating a conservation easement from 30% of their income in any year to 50%;

- An increase in the deduction a qualified farmer and rancher can take for donating a conservation easement from 30% to 100%; and
- An extension of the carry-forward period for a donor to take tax deductions for voluntary conservation agreements from five to 15 years.

With these provisions made permanent, the tax benefits of conservation easements will be tools that are readily available to more land owners of more modest incomes.

Capital Gains

The impact of capital gains taxes on farms and ranches is significant because production agriculture requires large investments in land and buildings that are held over very long periods of time and appreciate significantly. Capital gains taxes are also applied to the sale of timber as well as livestock used for breeding, dairy, and draft purposes. Unfortunately, farmers and ranchers often pay the top rate (which is assessed on high-income tax payers) because their capital gains can be realized in a single year (for example, when a farm is sold) even though the average income does not exceed the thresholds that would trigger the top rate. An unfortunate effect of capital gains taxes is their influence on the price and availability of farmland. Higher capital gains rates discourage the sale of property and ultimately increase the sale price for land—making it difficult for new farmers and ranchers to acquire land and for existing producers to expand their operations. We strongly discourage any increase to the capital gains rates and encourage you to consider other options that do not discourage agricultural production and growth.

We support your efforts to simplify the tax code in a way that also stimulates the economy.
Please understand that these provisions of the tax code serve as tools in the toolbox for farmers and ranchers whose land has provided food and fiber for American families for many generations and, hopefully, will continue to do so for future generations. We ask you to remember America's ranching families, whose wealth is tied up in land that has been taxed annually since it was originally settled and taxed again when transferred at the death of each farmer and rancher who wanted to pass on that legacy to the next generation. We have paid and will continue to pay our fair share of taxes. We simply ask that you consider the potential impact of these proposals before you move forward. Thank you for your consideration.

Sincerely,

Philip Ellis, President
National Cattlemen's Beef Association