UT Extension

Farm MANAGEment Minute

A monthly newsletter from the Department of Agricultural and Resource Economics

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Introductory Issue of Farm MANAGEment Minute

Welcome to the inaugural issue of Farm MANAGEment Minute. This brief monthly newsletter is intended to present farm management-related topics of interest to agricultural producers in and around Tennessee. Topics will include issues such as financial statement analysis, strategic planning, taxes, transition/estate planning, land values/leasing, machinery values/leasing, risk management, human resource management, technological advancements, and agricultural policy. Primary contributors will include Extension specialists from the UT Department of Agricultural and Resource Economics. If you have questions about a specific topic and think others would benefit from learning about it, do not hesitate to contact us, and we will find out more information for you and include an article in the newsletter. You may contact Jason Fewell, coordinator of the MANAGE Program in the Department of Agricultural and Resource Economics at the University of Tennessee, at 865-974-7410 or email jfewell@utk.edu.

The MANAGE Program is intended to help farm families achieve their life's goals. Help is offered on an individual basis to those who wish to improve their financial situation. All information is kept strictly confidential. Specialists can be found by contacting local Extension offices or by calling the MANAGE Information Line at 1-800-345-0561.

Land Values

It is difficult to open an agricultural news publication without seeing a story about land values these days. Increasing agricultural land prices continues to be a very popular topic in agriculture. High crop prices that have been in place for the last few years, sustained by demand for biofuels and a relatively weak dollar, continue to make grain farming profitable. Many news articles have been written about record high land prices, especially in the Midwest. Recently, many investment companies have purchased agricultural land because of its safe, steady returns. A recent survey by Farmers National Company, a property management company, indicates that farmland in Tennessee increased nearly 3 percent from January 2012 to January 2013. Countries and corporations are purchasing land and water resources in much of the developing world as well. Throughout Africa, southeast Asia and the Middle East, land and water resources are being purchased in anticipation of high profits created by producing food for an ever-increasing population, according to a recent article in Farm Press Daily. See http://southwestfarmpress.com/management/corporations-buying-land-globally-could-deplete-resources-corner-food-market for more information.

However, while agricultural land prices have increased dramatically in some large row crop producing areas since the recession began, prices in other areas are still struggling. A recent article by Saleem Shaik, Joseph Atwood and Glenn Helmers published in the Journal of Policy Modeling revealed results from their study involving changes in land values from 1938 to 2010 for nine regions of the U.S. They found that for the region including Arkansas, Kentucky, Tennessee and West Virginia, a 10 percent increase in the level of urbanization will increase land values by 6.2 percent — higher than for any other area of the country. This finding shows that this region faces the most competition for land from urban sprawl across the Lower 48. States along the Gulf of Mexico and in the Northeast would have land value increases of 4 percent and about 5 percent, respectively, while the rest of the U.S. would see increases below 3 percent if faced with a 10 percent increase in urbanization.

The study also determined that a 10 percent decrease in expected crop returns would decrease land values by 5.5 percent for the region including Tennessee. These decreases are smaller than those for areas of the Corn Belt and northern and southern Plains, but higher than decreases for the Gulf states and Mountain West, where agricultural income may be based on livestock, fruits and vegetables, or aquaculture more than on traditional field crops.

The authors also found that a 10 percent decrease in expected farm program payments will decrease land values by 1.42 percent for the Tennessee region, which is lower than for the rest of the U.S. This finding indicates that agricultural land values are influenced less by farm program payments in the Tennessee region than in the rest of the country. Finally, the authors determined that crop returns and program payments contributed 79.5 percent and 20.5 percent, respectively, to the value of agricultural land in the region. While the results from this study are not unexpected, the article offers some guidance on the magnitudes of changes in land values due to expected crop returns, agricultural policy and urbanization.

Since land values in the region including Tennessee are most influenced by urbanization, land prices will likely be influenced more by the general health of the U.S. economy than in areas of the country more heavily dependent on agriculture, such as the Midwest. In other words, downturns in the nation's economy will have a more noticeable effect on land values in Tennessee than in other areas.

While increasing urbanization may provide opportunities to produce locally grown fruits, vegetables or nursery crops as well as opportunities for agritourism, it is important for the economy to be healthy to support these activities. Anyone wishing to explore opportunities in these areas should consider the financial feasibility of adopting these enterprises and evaluate profit or loss potential carefully. It is especially important to consider the longevity of any venture before purchasing land.

For those people wishing to sell land, it is important to consider the capital gains that may result from the sale. Capital gains taxes are high at 15-20 percent, so it is important to work with a tax professional to understand the tax implications associated with land sales in these situations.

Still Tax Time!

In a normal year, farmers would have filed their 2012 taxes by March 1. However, because of changes associated with the legislation designed to avoid the "fiscal cliff" in January, the filing deadline changed to April 15 — the deadline for the majority of tax filers. While the 2012 tax season is in full swing, it is never too late to start planning for the 2013 tax year. In 2013, many significant changes will take place as a result of the passage of the American Taxpayer Relief Act of 2012. Many of these changes are important for agricultural producers.

The U.S. Congress and President Obama recently passed the American Taxpayer Relief Act of 2012, thereby averting the so-called fiscal cliff. Certain parts of the legislation may have significant impacts on individuals and businesses involved in agriculture. First, the plan will add a top marginal tax rate of 39.6 percent on income over $400,000 ($450,000 for married filing jointly and $425,000 for head of household), but does not change rates on incomes below $400,000. In addition, the payroll tax holiday that has been in place for the last two years has expired. Employees' share of the payroll tax will increase from 4.2 percent to 6.2 percent (not including Medicare/ Medicaid taxes of 1.45 percent). Employers did not experience a lower rate of payroll taxes during this time. Since many farmers are self-employed, they pay both the employer and employee shares of the tax. Their self-employment taxes will increase from 10.4 percent to 12.4 percent (not including Medicare/Medicaid taxes of 2.9 percent).

Capital gains and dividend tax rates will increase from 15 percent to 20 percent for those with incomes over $400,000 ($450,000 for married filing jointly and $425,000 for head of household). The 15 percent rate will still apply to those with incomes below this threshold.

These changes may have important implications for anyone selling land or other capital assets, especially as land values continue to increase and machinery values remain strong. The alternative minimum tax exemption amounts will increase, and the amount of allowable credits will increase for those subject to the AMT. For 2012, the exemptions are $50,600 for single and head of household filers, $78,750 for married filing jointly, and $39,375 for married filing separately. The AMT exemptions will be indexed to inflation beginning in 2013.

One of the most important tax issues in the bill relating to agriculture is the federal estate tax exemption. If the bill had not passed, the exemption would have reverted to $1 million, with tax rates of 55 percent for estates over that amount. Estate values have increased significantly in recent years as land values have increased. Therefore, decreasing the federal estate tax exemption would have hurt many farm families. For 2012, the amount exempt from federal estate taxes was $5.12 million, with a maximum tax rate of 35 percent above that amount. Beginning with the American Taxpayer Relief Act of 2012, the exemption amount is $5 million and will be adjusted for inflation each year. The maximum tax rate for estates over $5 million will be 40 percent. The inflation-adjusted estate tax exemption for 2013 is $5.25 million. While death and estate planning is not a pleasant or easy topic to talk about, if your goal is to ensure that most of the estate stays in the family, then it is important for you to make plans with your family accordingly.

Section 179 expensing for 2012 and 2013 is $500,000, with a maximum of $2 million invested. The benefit from this is that a farmer could expense much of the purchase price of new or used equipment (up to the allowable limit) to reduce taxes in the year during which the equipment was purchased. However, this benefit will lower the asset's tax basis for subsequent years, which will lower the amount of depreciation that can be taken in following years. After 2013, the amount of allowable expensing is scheduled to fall to $25,000 annually with a $200,000 investment limit. The 50 percent bonus depreciation is extended for 2013. This bonus allows a farm to accelerate depreciation on assets, but, again, will lower the allowable depreciation on assets in following years. For more information, see http://tax.cchgroup.com/downloads/files/pdfs/legislation/ATPR.pdf.

As always, contact a tax preparation professional to determine the optimal tax strategy for your personal or business situation.

Economic Highlights

The U.S. and global economies continue to improve slowly, but much more recovery is needed to reach prerecession levels (regardless of record high levels for the Dow Jones industrial average). The recent budget sequester will have impacts on the U.S. Department of Agriculture's budget, primarily in the form of reduced spending on research and employee furloughs, but the degree to which these spending cuts hurt agricultural producers is still uncertain.

In March, the Federal Reserve's Open Market Committee released a statement indicating that while the economy continues its recovery from the recession of 2008-2009, the pace of recovery is slow. While housing and business spending has increased, unemployment remains relatively high. Therefore, the committee has decided to keep long-term interest rates low to continue stimulating the mortgage markets and encourage business investment and consumer spending. They plan to keep this policy in place until the unemployment level falls below 6.5 percent. Therefore, it is likely that in 2013, and possibly 2014, long-term interest rates will be at or near zero.

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