

GAO

Briefing Report to the Honorable  
Bill Bradley, United States Senate

August 1986

# TAX POLICY

## Economic Effects of Selected Current Tax Provisions on Agriculture



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United States  
General Accounting Office  
Washington, D.C. 20548

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General Government Division

B-220507

August 11, 1986

The Honorable Bill Bradley  
United States Senate

Dear Senator Bradley:

In December 1985, you asked us to review how current tax law affects the agricultural sector. We did so, and briefed you in detail on our results. We also conducted briefings for Senator Melcher and staff members of Senators on the Senate Democratic Policy Committee. Subsequently, your staff asked us to provide you with a written document containing the basic focus of our briefing.

The information contained in appendix I highlights the points covered in our briefing and is presented without lengthy discussion or analysis. The specific points deal with: (1) the distribution of farms and income; (2) farm profits and losses claimed by individual taxpayers; (3) the economic effects of selected current tax provisions; and (4) the amount and distribution of nonfarm income reported by taxpayers filing a Schedule F (Farm Income and Expenses).

We obtained our information by (1) reviewing the results of analyses reported in economic and legal journals; (2) discussing the issues with economic experts at the Department of Agriculture, the Department of the Treasury, and the Congressional Research Service; and (3) gathering both published and unpublished data from various agencies and sources detailed in this report. We attempted to synthesize the views of experts and present a consensus where one exists. For example, a consensus exists that, under current tax law, favorable taxation of farm capital has tended to contribute to greater farm output and lower farm prices than would have occurred otherwise. Provisions in the Senate Tax Reform Bill would contribute to a reversal of these effects. It is important to note that, in doing our work, we confined ourselves to gathering only that information on the agricultural sector that related to tax policy. Thus, we did not analyze the effects on farming of other important economic factors such as inflation and international trade.

As requested by your office, we did not obtain official agency comments. We have, however, discussed our information with representatives from the Department of Agriculture and incorporated their comments where appropriate.

As arranged with your office, we are sending copies of this report to the Department of Agriculture, the Department of the Treasury, congressional committees that oversee the tax area, and other organizations that provided us with data. Copies will be made available to others who request them. If you or your staff have questions regarding this information, please contact Charles Vehorn of my staff on 376-0023.

Sincerely yours,

A handwritten signature in cursive script that reads "Johnny C. Finch". The signature is written in dark ink and is positioned above the typed name.

Johnny C. Finch  
Senior Associate Director

C o n t e n t s

APPENDIX

|   | <u>Page</u> |
|---|-------------|
| I Information on Taxation in the<br>Agricultural Sector | 4           |
| II Bibliography   | 12          |

TABLE

|  |    |
|--|----|
| I.1 Distribution of Farms, Cash Receipts,<br>Farm Income, and Nonfarm Income by<br>Sales Class, 1984 | 5  |
| I.2 Farm Individual Tax Returns and Total<br>Individual Tax Returns for 1983                         | 7  |
| I.3 Effect of Current Tax Provisions<br>on Agriculture: Review of Past<br>Studies                    | 9  |
| I.4 Farm and Nonfarm Income of Schedule F<br>Filers, 1982 Individual Income<br>Tax Returns           | 11 |

INFORMATION ON TAXATION IN THE AGRICULTURAL SECTOR

DISTRIBUTION OF FARMS AND THEIR INCOME IN 1984 (TABLE I.1)

Highlights from table I.1 include the following:

- Based on the Census of Agriculture definition of a farm operation, the U.S. Department of Agriculture estimated that in 1984 the number of farms was 2.3 million.
- While small farms with annual sales of less than \$20,000 made up about 60 percent of all farms in the U.S., large farms with annual sales of \$250,000 or more (4.6 percent of all farms) accounted for almost half of gross cash income and almost three-fourths of net farm income in 1984.
- Average nonfarm income was highest for farms with less than \$40,000 in sales, and smallest for farms with sales between \$40,000 and \$249,999.
- Average nonfarm income was higher than average net farm income for farms with less than \$100,000 in sales. In other words, on average, farm operators with farm sales of less than \$100,000 in 1984 derived most of their income from nonfarm sources.

Table I.1

DISTRIBUTION OF FARMS, CASH RECEIPTS, FARM INCOME, AND  
NONFARM INCOME BY SALES CLASS, 1984

| FARMS WITH<br>SALES OF-- | NO. OF FARMS<br>(THOUSANDS) | PERCENT<br>OF FARMS | PERCENT OF<br>GROSS CASH<br>INCOME | PERCENT OF<br>NET FARM<br>INCOME | AVERAGE<br>NET FARM<br>INCOME | PERCENT OF<br>NONFARM<br>INCOME | AVERAGE<br>NONFARM<br>INCOME | AVERAGE<br>TOTAL<br>INCOME |
|--------------------------|-----------------------------|---------------------|------------------------------------|----------------------------------|-------------------------------|---------------------------------|------------------------------|----------------------------|
| \$500,000 AND OVER       | 31                          | 1.3                 | 31.2                               | 49.5                             | \$423,063                     | 1.1                             | \$14,438                     | \$437,501                  |
| \$250,000 TO \$499,999   | 77                          | 3.3                 | 17.7                               | 23.6                             | \$81,875                      | 2.2                             | \$11,471                     | \$93,346                   |
| \$100,000 TO \$249,999   | 229                         | 9.9                 | 24.4                               | 27.4                             | \$31,878                      | 6.1                             | \$10,690                     | \$42,658                   |
| \$40,000 TO \$99,999     | 353                         | 15.2                | 16.0                               | 8.0                              | \$6,073                       | 8.6                             | \$9,719                      | \$15,791                   |
| \$20,000 TO \$39,999     | 247                         | 10.6                | 5.0                                | 0.4                              | \$392                         | 13.0                            | \$21,082                     | \$21,473                   |
| \$10,000 TO \$19,999     | 269                         | 11.6                | 2.8                                | -1.5                             | (\$1,471)                     | 11.9                            | \$17,725                     | \$16,253                   |
| \$5,000 TO \$9,999       | 314                         | 13.5                | 1.7                                | -1.8                             | (\$1,538)                     | 15.8                            | \$20,150                     | \$18,612                   |
| \$2,500 TO \$4,999       | 275                         | 11.8                | 0.7                                | -2.3                             | (\$2,228)                     | 13.4                            | \$19,427                     | \$17,198                   |
| LESS THAN \$2,500        | 533                         | 22.8                | 0.5                                | -3.3                             | (\$1,648)                     | 27.9                            | \$20,935                     | \$19,287                   |
| ALL FARMS                | 2,328                       | 100.0               | 100.0                              | 100.0                            | \$11,471                      | 100.0                           | \$17,188                     | \$28,659                   |

SOURCE. Economic Indicators of the Farm Sector: National Financial Summary, 1984, United States Department of Agriculture, Economic Research Service

AGGREGATE FARM LOSSES IN 1983 EXCEEDED FARM PROFITS (TABLE I.2)

- As shown in table I.2, in 1983 slightly more than 2.7 million individual taxpayers filed a Schedule F, which reports farm income and losses.
- Table I.2 also shows that, per individual income tax returns for 1983, aggregate net farm losses exceeded net farm profits by an estimated \$9.3 billion.

Table I.2

FARM INDIVIDUAL TAX RETURNS AND TOTAL  
INDIVIDUAL TAX RETURNS FOR 1983

| TYPE OF RETURN                                    | NUMBER<br>OF RETURNS | INCOME               |
|---|----------------------|----------------------|
| FARM RETURNS WITH NET INCOME                      | 968,248              | \$8,425,995,000      |
| FARM RETURNS WITH NET LOSSES                      | 1,741,796            | (\$17,720,479,000)   |
| ALL FARM RETURNS                                  | 2,710,044            | (\$9,294,484,000)    |
| <br>  |                      |                      |
| TOTAL INDIVIDUAL RETURNS                          | 96,321,310           | \$1,942,589,865,000* |
| <br>  |                      |                      |
| ALL FARM RETURNS AS A PERCENT<br>OF TOTAL RETURNS | 2.81%                |                      |

NOTE: All figures are estimates based on samples. Numbers in parentheses designate losses, i.e., negative income.

\*Adjusted gross income less deficit. A deficit occurs if the allowable exclusions and deductions exceed gross income.

SOURCE: Individual Income Tax Returns: 1983, Internal Revenue Service, Statistics of Income Division.

ECONOMIC EFFECTS OF CURRENT TAX PROVISIONS (TABLE I.3)

Both general tax provisions (taxes on capital, tax shelters, income averaging, and taxes on labor) and farm-specific provisions (cash accounting, special expensing, sale of erodible croplands, and estate taxation) affect resource allocation. Table I.3 illustrates where we found a consensus in the literature on the direction of change. (Blank cells indicate we found little evidence or no consensus.) Some highlights include the following:

- The economic effect of current tax provisions on capital has been to encourage a movement of more capital resources into the farm sector than would otherwise have occurred. This has tended to (1) increase output, (2) put downward pressure on commodity prices, and (3) put upward pressure on the value of farm land, a relatively fixed input.
- We found a consensus that those in higher tax brackets were the relative gainers from tax shelters.
- We found no consensus on how employment taxes affect farm labor.
- For the farm-specific provisions, we found a consensus that cash accounting had effects similar to the tax provisions on capital.
  - The Department of Agriculture stated in a recent publication that, based upon federal income tax returns, about 98 percent of farm sole proprietorships in 1982 used the cash method of accounting. So did many farm corporations and partnerships.
  - In a March 1986 publication the Congressional Budget Office (CBO) noted that tax revenues could be increased if cash accounting was restricted to certain small- to medium-sized businesses. The CBO estimated that if this restriction took effect on January 1, 1987, it would increase federal revenues by about \$5 billion over the 1987-1991 period.
- We found no consensus on special expensing provisions and provisions on the sale of erodible land.
- We found a consensus that current estate tax provisions, because they lower the tax on heirs, put upward pressure on land prices.

Table I.3

EFFECT OF CURRENT TAX PROVISIONS ON AGRICULTURE:  
REVIEW OF PAST STUDIES\*

| TAX PROVISIONS                      | RESOURCE ALLOCATION |             |           |                   |              | MAJOR BENEFICIARIES |                |                          |
|-------------------------------------|---------------------|-------------|-----------|-------------------|--------------|---------------------|----------------|--------------------------|
|                                     | COMMODITY PRICE     | FARM OUTPUT | FARM SIZE | CAPITAL USER COST | LABOR PRICE  | LAND PRICE          | LAND OWNERS    | HIGHER BRACKET TAXPAYERS |
| <b>GENERAL PROVISIONS</b>           |                     |             |           |                   |              |                     |                |                          |
| TAXES ON CAPITAL                    |                     |             |           |                   |              |                     |                |                          |
| CAPITAL GAINS                       | FALLS               | RISES       |           |                   |              | RISES               | REDUCES        |                          |
| INVESTMENT TAX CREDIT               | FALLS               | RISES       |           | FALLS             |              |                     | TAX            |                          |
| ACCELERATED DEPRECIATION            | FALLS               | RISES       |           | FALLS             |              |                     | PAYMENTS       |                          |
| PASSIVE, TAX SHELTER LOSSES         | FALLS               | RISES       |           |                   |              | RISES               |                | RELATIVE GAINERS         |
| INCOME AVERAGING                    |                     |             |           |                   |              |                     |                |                          |
| TAXES ON LABOR                      |                     |             |           |                   |              |                     |                |                          |
| SOCIAL SECURITY                     |                     |             |           |                   | INCIDENCE IS |                     |                |                          |
| UNEMPLOYMENT INSURANCE              |                     |             |           |                   | UNKNOWN      |                     |                |                          |
| WORKERS COMPENSATION                |                     |             |           |                   |              |                     |                |                          |
| <b>FARM-SPECIFIC PROVISIONS</b>     |                     |             |           |                   |              |                     |                |                          |
| CASH ACCOUNTING                     |                     |             |           |                   |              |                     |                |                          |
| INVENTORIES                         | FALLS               | RISES       | RISES     |                   |              | RISES               | CREATES HIGHER |                          |
| PREPAYMENTS                         | FALLS               | RISES       |           |                   |              |                     | VALUED         |                          |
|                                     |                     |             |           |                   |              |                     | TAX ASSET      |                          |
| <b>SPECIAL EXPENSING PROVISIONS</b> |                     |             |           |                   |              |                     |                |                          |
| SOIL AND WATER CONSERVATION         |                     |             |           |                   |              |                     |                |                          |
| FERTILIZER AND SOIL                 |                     |             |           |                   |              |                     |                |                          |
| CONDITIONING                        |                     |             |           |                   |              |                     |                |                          |
| LAND CLEARING                       |                     |             |           |                   |              |                     |                |                          |
| <b>SALE OF ERODIBLE CROPLANDS</b>   |                     |             |           |                   |              |                     |                |                          |
| <b>ESTATE TAXATION</b>              |                     |             |           |                   |              |                     |                |                          |
| SPECIAL-USE VALUATION               |                     |             |           |                   |              | RISES               | TAX ON         |                          |
| INSTALLMENT PAYMENT                 |                     |             |           |                   |              | RISES               | HEIR FALLS     |                          |

\*See bibliography (app. II) for sources.  
Blank cells indicate we found little evidence or no consensus.

6

DISTRIBUTION IN 1982 OF FARM AND NONFARM INCOME FOR THOSE FILING  
A SCHEDULE F (TABLE I.4)

Using unpublished data from the IRS, we tabulated farm and nonfarm income. Some highlights include the following:

- About 90 percent of the 2.7 million individuals who filed a Schedule F (Farm Income and Expenses) in 1982 reported having nonfarm income of \$50,000 or less, with about 35 percent having nonfarm income of \$10,000 or less.
- In comparison, less than 1 percent reported farm income over \$50,000, while 91 percent reported farm income of \$10,000 or less.
- About 65 percent of the filers reported farm losses, with about 8 percent reporting losses between \$15,000 and \$49,999, and 2 percent reporting losses of \$50,000 or greater.
- About 8 percent of the filers reported both nonfarm income greater than \$50,000 and farm losses. This group represents about 13 percent of all those reporting farm losses; about 29 percent of all those reporting farm losses of \$15,000 or greater reported nonfarm income greater than \$50,000. Farm losses generate larger tax reductions for those with higher levels of nonfarm income because these individuals have higher marginal tax rates.

Table I.4

FARM AND NONFARM INCOME OF SCHEDULE F FILERS,  
1982 INDIVIDUAL INCOME TAX RETURNS (\*\*)

| NONFARM INCOME                  | FARM INCOME             |                          |                    |                  |                       |                        |                        |                         |                         |                 | PERCENT OF<br>TOTAL<br>INDIVIDUALS |
|---------------------------------|-------------------------|--------------------------|--------------------|------------------|-----------------------|------------------------|------------------------|-------------------------|-------------------------|-----------------|------------------------------------|
|                                 | -50,000<br>AND<br>BELOW | -49,999<br>TO<br>-15,000 | -14,999<br>TO<br>0 | 1<br>TO<br>5,000 | 5,001<br>TO<br>10,000 | 10,001<br>TO<br>25,000 | 25,001<br>TO<br>50,000 | 50,001<br>TO<br>150,000 | 150,001<br>AND<br>ABOVE | TOTAL           |                                    |
| 5,000 AND BELOW                 | 14<br>-3,104            | 42<br>-2,111             | 185<br>-1,326      | 190<br>325       | 81<br>464             | 86<br>1,218            | 23<br>577              | 6<br>153                | *                       | 630<br>-3,832   | 23 4                               |
| 5,001-10,000                    | 3<br>-281               | 19<br>-315               | 137<br>563         | 86<br>759        | 23<br>330             | 32<br>734              | 8<br>328               | 1<br>86                 | *                       | 309<br>2,236    | 11 5                               |
| 10,001-20,000                   | 3<br>-214               | 29<br>-308               | 368<br>4,039       | 114<br>1,784     | 26<br>531             | 28<br>790              | 12<br>552              | 2<br>147                | *                       | 581<br>7,341    | 21 6                               |
| 20,001-50,000                   | 7<br>370                | 76<br>704                | 654<br>17,242      | 120<br>3,706     | 21<br>726             | 23<br>994              | 8<br>480               | 3<br>272                | *                       | 911<br>23,761   | 33 8                               |
| 50,001-100,000                  | 7<br>-161               | 40<br>1,527              | 116<br>6,373       | 20<br>1,385      | 3<br>212              | 5<br>384               | 2<br>134               | 1<br>191                | *                       | 194<br>10,076   | 7 2                                |
| 100,001-500,000                 | 15<br>1,250             | 15<br>2,135              | 24<br>3,667        | 4<br>626         | 1<br>160              | 2<br>346               | 1<br>171               | *                       | *                       | 62<br>8,611     | 2 3                                |
| 500,001 AND ABOVE               | 2<br>1,880              | 1<br>850                 | 1<br>824           | *                | *                     | *                      | *                      | *                       | *                       | 4<br>4,500      | *                                  |
| TOTAL                           | 51<br>-999              | 221<br>2,482             | 1,486<br>31,382    | 534<br>8,869     | 155<br>2,537          | 175<br>4,587           | 54<br>2,414            | 14<br>1,092             | 1<br>326                | 2,692<br>52,691 |                                    |
| PERCENT OF<br>TOTAL INDIVIDUALS | 1 9                     | 8 2                      | 55 2               | 19.8             | 5 8                   | 6.5                    | 2                      | *                       | *                       |                 |                                    |

NOTE The top figure in each farm-nonfarm income category is number of individuals in thousands. The bottom figure in each category is total adjusted gross income in millions of dollars for all individuals in the category.

\*LESS THAN 500 INDIVIDUALS PREDICTED TO BE IN THE CATEGORY.  
OR NO MORE THAN HALF OF A PERCENT OF TOTAL

\*\*ESTIMATES FOR THE ENTIRE UNIVERSE OF SCHEDULE F FILERS ARE BASED ON A  
WEIGHTED SAMPLE OF 15,481 RETURNS FROM THE 1982 IRS SAMPLE OF RETURNS  
INCLUDING SCHEDULE F TOTALS MAY NOT ADD DUE TO ROUNDING

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