Briefs

Ag Economy

New Tax Law Includes Savings for Farmers

The Economic Growth and Tax Relief Reconciliation Act of 2001, signed into law on June 7, 2001, makes significant changes to U.S. tax law. Most of the law's provisions apply to farmers as general taxpayers.

The law reduces Federal income taxes in several ways, with the largest cut being an across-the-board reduction in marginal income tax rates. It increases income tax benefits for families with children, primarily by expanding the child tax credit. It also addresses the "marriage penalty" that has resulted in some couples paying more tax than if they were single. It increases education incentives and allows higher contributions and greater flexibility for individual retirement accounts and pensions. Federal estate taxes will be reduced and eventually repealed, a cut advocated to help farmers and small businesses.

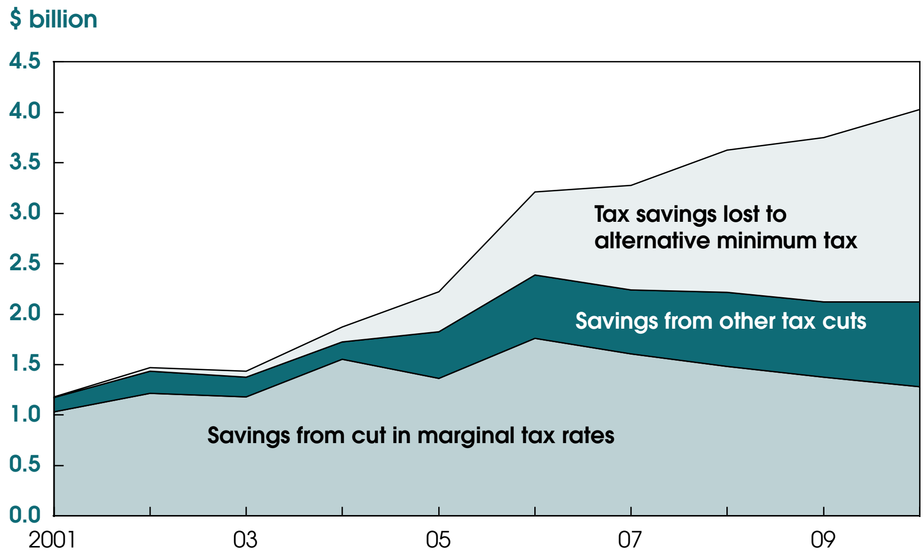
The law creates a new 10-percent income tax bracket for the first $12,000 of taxable income on a joint return ($6,000 for singles). Marginal tax rates also are reduced for the 28-, 31-, 36- and 39.6-percent income tax brackets (the 15-percent bracket rate remains unchanged). The reductions are gradual and become fully effective in 2006 when the rates will be 25, 28, 33 and 35 percent, respectively.

The new 10-percent bracket for a portion of taxpayers' income is the basis for the special refund checks currently being mailed by the Internal Revenue Service between July and the end of September. The checks are a one-time advance payment of some of the 2001 tax savings. Nearly two-thirds of farmers are expected to receive the maximum refund, which for a joint return is $600.

About 85 percent of farmers will benefit from the income tax reductions specified in the new law. Prior to passage, farmers were expected to pay a total of $26 billion in Federal income taxes in 2001 on farm and nonfarm income. Under the new law, farmers are likely to save $1.2 billion in income taxes during 2001. The present value—the value of money received in the future, discounted for inflation into today's dollars—of projected tax savings for farmers in the year 2010, when all provisions will be in force, is $2.1 billion.

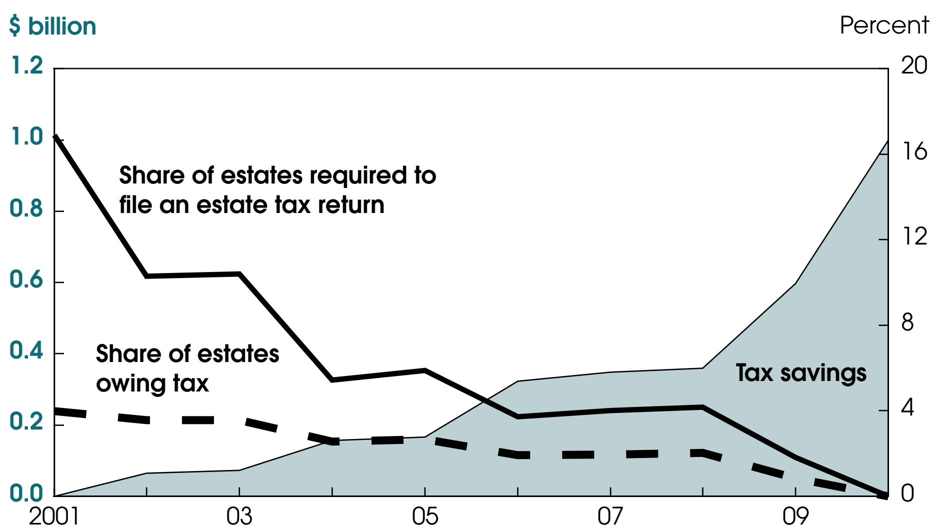
The present value of Federal income tax savings over the entire 10-year phase-in period is expected to be about $19 billion for all farmers. The savings would be even greater without the offsetting effect

Tax Act to Provide Savings for Farm Sole Proprietors. . .



Annual income tax cut for farm sole proprietors in present value (the value of money received in the future, discounted for inflation into today's dollars).
Source: ERS simulation using Internal Revenue Service data.

. . .and for Farm Estates



Amounts in present value.
Source: ERS simulation using data from the USDA Agricultural Resource Management Study.

Economic Research Service, USDA

of the alternative minimum tax (AMT). AMT was designed to reduce the ability of higher income individuals to escape taxes by using certain deductions. It applies a parallel tax system on a broader base of income, and taxpayers pay the greater amount of their regular tax or the AMT. The AMT already was expected to rise significantly prior to the law's passage, primarily because its exemption is not indexed for inflation.

Income tax rate reductions accelerate the growth in the total amount paid under AMT since AMT rates remain unchanged, although the new law temporarily increases the amount of income not subject to AMT through 2004. Currently only 2 percent of farmers pay AMT, but that number is expected to rise to 33 percent by 2010 without further AMT relief. If AMT were held at 2001 levels, the 10-year sum of the income tax cut for farmers would be $26 billion. Therefore, the rising incidence of AMT reduces farmers' income tax cut by more than one-fourth over the decade to $19 billion.

The law also makes changes that will greatly reduce the number of farm estates affected by the Federal estate tax. Before repeal of the estate tax in 2010, the most significant change is to increase the dollar amount of property exempted from tax from the current $675,000 to $3.5 million by raising the unified credit. The unified credit allows each estate to transfer a certain lifetime amount of property free of estate and gift taxes. The new law also gradually reduces the maximum estate tax rates from 55 to 45 percent and expands the availability of deductions for donating conservation easements. The law repeals the family business deduction when exemption from the unified credit reaches $1.5 million, exceeding the $1.3 million currently allowed under the family business deduction and unified credit.

While these changes will reduce the amount of Federal estate taxes owed, the most dramatic effect will be a sharp drop in the number of farm estates required to file an estate tax return. By 2004, when the amount exempted by the unified credit reaches $1.5 million, only about a third of those farm estates that currently are required to file would need to file an estate tax return. This represents large cost savings for farm estates that are no longer required to file. However, because of the extended phase-in, larger estates may still face considerable complexity, since they may still owe tax and be required to file, depending on date of death of the property owner.

The number of estates owing taxes and the amount of estate taxes owed will decline more gradually, with both falling about 10 percent in 2002. Over the next decade, farmers are expected to save about $3 billion in Federal estate taxes.

The new law reduces both income and estate taxes for most taxpayers, including most farmers. While savings begin in 2001, many reductions are implemented gradually. Without future action, however, the law expires in 2011, and provisions revert to pre-reform levels. AO

James Monke (202) 694-5358 and Ron Durst (202) 694-5347
jmonke@ers.usda.gov
rdurst@ers.usda.gov

Livestock, Dairy, & Poultry

Financial Prospects for Hog Producers Generally Favorable

The national hog inventory this year has remained at 59.1 million head, about the same as last year, despite relatively favorable returns. Over the last 18 months, hog prices have averaged in the mid-$40s per cwt, topping producers' mid-$30s breakeven (cash) costs. Producers have signaled intentions to increase the number of sows farrowing over the next 6 months, according to the USDA's June *Hogs and Pigs* report. Producers plan to have 1 percent more sows farrow in June-August and 2 percent more in September-November than actual farrowings in these periods a year earlier.

The changing structure of hog production and the industry's financial problems in late 1998 and most of 1999 have muted hog producers' response to prospects of favorable returns. Many smaller producers exited the industry in the late 1990s. Smaller producers that remain may still be recovering from financial problems. Lenders are also likely to be more cautious about financing hog operations.

If producers follow through with their farrowing intentions, and if only a small increase in pigs per litter occurs as expected, the June-August pig crop should be up about 1 percent from a year ago and the September-November number up 2 percent. These projections imply a January-March 2002 hog slaughter of nearly 25 million head and second-quarter slaughter of nearly 24 million head. With dressed weights increasing slightly, first-half 2002 pork production is expected to be 2-3 percent higher than a year earlier.

With expectations of continued positive returns for hog producers in the coming months, the December 2001-May 2002 pig crop should increase nearly 3 percent over a year earlier. Feed costs are expected to remain unchanged into 2002 as a large corn crop and record soybean crop move to market. Although hog prices are expected to moderate in the coming months, producers' returns should remain positive. The larger expected pig crop and slightly heavier dressed weights should boost pork production in the second half of 2002 by 3-4 percent.

Hog prices climbed into the mid-$50s per cwt in late spring and early summer as slaughter rates declined seasonally. Also contributing to the rise were strong exports, brisk demand for bacon, especially in the fastfood industry, record retail beef prices (which make pork more attractive to consumers), and a slight decline in broiler supplies. As slaughter increases seasonally in late summer, prices are expected to moderate. In the late fall, when slaughter reaches a seasonal peak, hog prices are expected to drop into the