Farmland IN PERSPECTIVE

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GLAUB FARM MANAGEMENT

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97% of U.S. farms are family-owned

The U.S. Department of Agriculture National Agricultural Statistics Service (NASS) reports that family-owned farms remain the backbone of the agriculture industry. The latest data comes from the Census of Agriculture farm typology report and helps shine light on the question, "What is a family farm?"

The *2012 Census of Agriculture Farm Typology* report is a special data series that primarily focuses on the "family farm." By definition, a family farm is any farm where the majority of the business is owned by the operator and individuals related to the operator, including through blood, marriage, or adoption.

Key highlights from the report include:

- **Food equals family – 97% of the 2.1 million farms in the United States are family-owned operations.**
- **Small business matters – 88% of all U.S. farms are small family farms.**
- **Local connections come in small packages – 58% of all direct farm sales to consumers come from small family farms.**
- **Big business matters too – 64% of all vegetable sales and 66% of all dairy sales come from the 3% of farms that are large or very large family farms.**
- **Farming provides new beginnings – 18% of principal operators on family farms in the U.S. started within the last 10 years.**

Plan now to reduce taxes later

by Michael G. Barton

Black Gold. The phrase historically has described the oil industry, at least before 2014. Today it can also describe prime Midwestern farmland.

While the financial condition of the U.S. economy took a substantial downturn in 2004 and the following years, the agricultural community remained strong. Record high corn prices followed, which led to higher cash rents and subsequently higher farmland values.

The current level of farmland values can cause individuals to contemplate whether they should sell their property. For persons with significant farmland holdings, today's higher values create substantially higher net worth. This might result in potential estate taxes which may not be anticipated by the family.

Lifetime Sale

If landowners are contemplating a possible sale of farmland, it is necessary to determine the income tax consequences from any such sale. Gain or loss is computed by subtracting one's tax basis from the sale price. The tax basis is based on how the farmland was acquired. *If the farmland was:*

- Purchased, the basis is equal to the purchase price.
- Inherited, the basis is equal to the value of the farmland when it was inherited.
- Received by gift, then the basis is equal to the basis which the donor of the gift had at the time of the gift.

If the farmland has been held for more than one year, then the gain is eligible for long-term capital gain treatment. If the farmland is sold at a loss, the loss is considered an ordinary loss for tax purposes. The level of capital gain tax to be paid is based on the individual's tax bracket. *For joint tax filers in 2015, the rates are as follows:*

2015 Federal Tax Rates

TAXABLE INCOME	INCOME TAX RATE	CAPITAL GAIN RATE
$0 – $18,450	10.0%	0.0%
$18,450 – $74,900	15.0%	0.0%
$74,900 – $151,200	15.0%	15.0%
$151,200 – $230,450	28.0%	15.0%
$230,450 – $411,511	33.0%	15.0%
$411,500 – $464,850	35.0%	15.0%
$464,850 and above	39.6%	20.0%

Continued on page 2

Plan Now *continued from page 1*

For example, if a couple inherited a 100-acre farm in 1980 with a value of $3,000 per acre and could sell that farm today for $13,000 per acre, a capital gains of $1,000,000 would be included on their tax return. As shown by the chart, the capital gain would be subject to a 20% federal tax rate. Applicable state income taxes would also be owed.

In addition to the capital gains tax, individuals today must also take into account the net investment income tax, which began in 2013. For joint tax filers, this represents an additional 3.8% of tax which is imposed on the lesser of 1.) The owners' net investment income for the year, or 2.) The owners' adjusted gross income in excess of $250,000.

Unfortunately, when computing net investment income, the gain from the sale of the farmland is included. The one exception is farmland that was held in an active trade or business. For farmland that was held for investment purposes, the gain will be subject to the additional 3.8% of tax in addition to the capital gains tax.

To avoid this level of tax, three planning options can be considered:

Installment Sale. Instead of recognizing all of the gain in one year, an individual can sell farmland on an installment basis. Under an installment sale, the gain is spread out over the length of the contract. This may allow the effective capital gain rate to be reduced to zero and also may allow individuals to avoid the 3.8% net investment tax.

Exchange. The tax provisions allow landowners to sell property but defer the tax under Section 1031. Under this provision, the tax is deferred if the landowner reinvests the proceeds from the sale of farmland in other real estate that is either used in a trade or business or held for investment purposes.

The new property does not have to be farmland, but it does have to be real estate. This is often referred to as a tax deferral, since the tax basis in the property that is sold is transferred to the new real estate which is purchased as part of the exchange.

Hold the Property Until Death. When an individual owns property at death, the persons who inherit the property receive a new income tax basis in that property which is equal to the value of that property at the time of the death. Therefore, if one has low basis property, the tax liability that is owed from a sale can be totally avoided if the property is sold by the heirs after death.

Estate Tax Considerations

Landowners would also be well advised to review how their farmland value impacts their overall exposure to estate taxes. Although the estate tax exemption level in 2015 is $5,430,000 per person, this level is often fully utilized by only the current value of farmland, without considering any other investments, homes or other property which one might own. If a landowner has property in excess of the allowable federal exemption, the tax rate is 40% on the excess.

Unfortunately, if one owns land in Illinois, a different rate applies. A death tax is owed when one's property exceeds $4,000,000 in value. Therefore, if an Illinois resident has $5,430,000 of assets, there is no federal estate tax, but the estate owes $395,468 to the State of Illinois.

Payment of any taxes by an estate may require the sale of other assets, borrowing money or selling of farmland. With taxes due within nine months after one's death, the short time frame may make it difficult to sell assets at an optimum value.

Two planning options are available to farmland owners to reduce or minimize estate taxes: Section 6166 and Section 2032A. Under Section 6166, the government will allow an estate to pay its tax over 15 years at a 2% rate of interest. This option is only available for assets which are involved in a trade or business. This requires that the farmland be involved in some type of a crop share lease by the decedent. It does not require material participation but does require being at risk to the crop production.

The second option is Section 2032A, the family farm exception. Under this provision, if all the requirements are met, the value of the farmland can be reduced by $1,100,000 for each estate in 2015. This can result in over $400,000 of federal tax savings per landowner. It also will reduce the estate tax liability for any applicable state

Americans, on average, spend less than 10% of their incomes on food

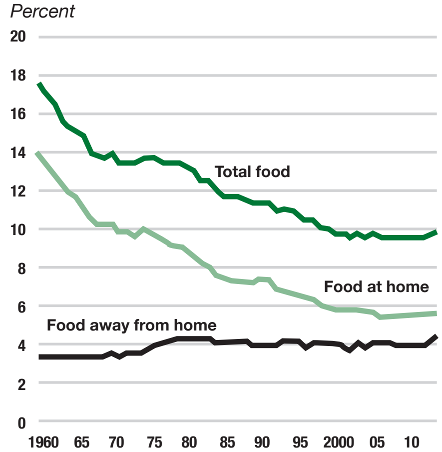
Between 1960 and 2007, the share of disposable personal income spent on total food by Americans fell from 17.5% to 9.6%, according to the Economic Research Service of the U.S. Department of Agriculture as the share of income spent on food at home fell.

The share of income spent on food purchased in grocery stores and other retailers declined from 14.1% in 1960 to 5.5% in 2007. Meanwhile the percent of income spent on food purchased at restaurants, fast food places, and other away-from-home eating places increased from 3.4% to 4.1%.

The share of income spent on total food began to flatten in 2000, as inflation-adjusted incomes for many Americans have stagnated or fallen over the last decade or so. In addition, between 2006 and 2013, food price inflation has been greater than overall inflation, making food more costly. In 2013, Americans spent 5.6% of their disposable personal incomes on food at home and 4.3% on food away from home.

Source: USDA, Economic Research Service. Food Expenditure Series, table 7.

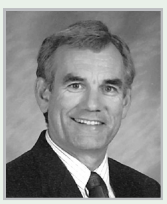
Per capita disposable income spent on food in the United States, 1960–2013



taxes, even if there is no federal estate tax liability.

Although several requirements must be met to utilize Section 2032A, the primary requirement is that the owner or a family member either materially participated under a crop share lease or rents the farm to a family member. In addition, the farmland must continue to be held and managed by the family for 10 years following death.

In summary, higher farmland values generally are viewed as favorable. However, for farmland owners who are contemplating a sale of the farmland or who may be facing estate tax situations, higher values are causing additional tax planning which benefits them upon completion.



Michael G. Barton *is an ag law attorney in Springfield, Illinois. He grew up on a grain and livestock farm in west central Illinois near Pittsfield. He received his Bachelor's and Master's degrees in agricultural economics at the University of Illinois followed by a law degree from the University of Illinois. Prior to law school, Barton worked as a farm consultant and income tax preparer for farmers and landowners through Farm Business Farm Management. Barton's law practice concentrates in real estate, business planning, income tax planning, estate planning, and trust and estate administration for farmers and landowners. Barton has been identified as a Leading Illinois Attorney in Agricultural Law.*

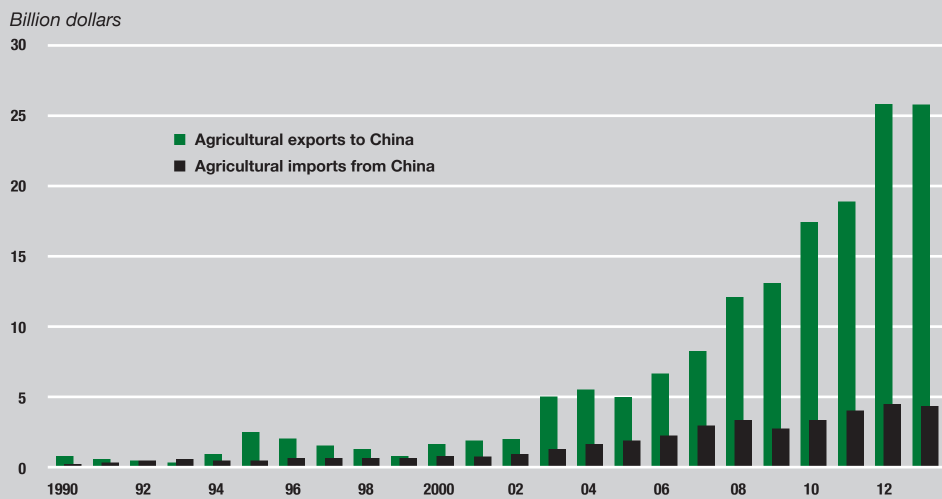
U.S. ag trade surplus with China grows and expands

In recent years, growth in U.S.–China agricultural trade has accelerated. During calendar years 2012-13, U.S. exports of agricultural products to China averaged $25.9 billion per year – a tenfold increase from the late 1990s, according to the Economic Research Service of the U.S. Department of Agriculture. Sales to China doubled during 2004-08 and doubled again during 2008-12, while the share of U.S. agricultural exports going to China rose from about 3% during the 1990s to 18% during 2012-13.

China became the largest overseas market for U.S. farm products in 2010. U.S. imports of agricultural products from China rose at a slower pace, reaching $4.4 billion in 2013 – agriculture is one of the few sectors where the United States has a trade surplus with China.

During 2012-13, the United States accounted for more than 24% of China's agricultural imports by value and was its leading supplier of oilseeds, cotton, meat, cereal grains, cattle hides, distillers' dried grains – mainly used for animal feed – and hay. Soybeans account for more than half of the total value of U.S. agricultural exports to China, averaging $14.1 billion during the 2012-13 calendar years, and are also the largest U.S. export of any type to China, accounting for about 11% of the value of total U.S. exports to China.

U.S. agricultural trade with China, 1990–2013



Source: USDA, Economic Research Service analysis of data from USDA. Foreign Agricultural Service. Global Agricultural Trade System.

Half of U.S. cropland on 1,200+ acre farms

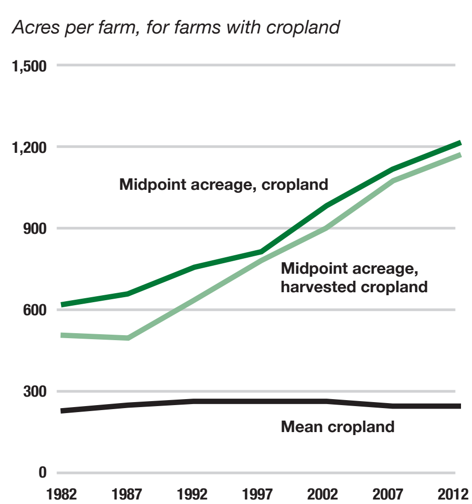
The average (mean) number of acres on crop farms has changed little in the past three decades. It has increased slightly, from 241 acres in 2007 to 251 in 2012, according to the Economic Research Service of the U.S. Department of Agriculture.

The mean, however, misses an important element of changing farm structure. It has remained stable because while the number of mid-size crop farms has declined over several decades, farm numbers at the extremes (large and small) have grown.

With only modest changes in total cropland and the total number of crop farms, the size of the average (mean) farm has changed little. Commercial crop farms, which account for most U.S. cropland, however, have gotten larger, aided by technologies that allow a single farmer or farm family to farm more acres.

The midpoint acreage (at which half of all cropland acres are on farms with more cropland than the midpoint, and half are on farms with less) effectively tracks cropland consolidation over time. The midpoint acreage of total and harvested cropland has increased over the last three decades, from roughly 500–600 acres in 1982 to approximately 1,200 acres in the most recent census of agriculture data (2012).

Three measures of average farm size, 1982–2012



Note: "Midpoint acreage" is the farm size where half of all cropland acres are on farms with more cropland than the midpoint, and half are on farms with less. "Mean" cropland is the total number of cropland acres divided by the total number of farms with cropland.

Source: USDA, National Agricultural Statistics Service, Census of Agriculture (for mean cropland), and ERS calculations from farm-level Census of Agriculture date (for midpoint acreages).

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