Federal Reserve Bank of Chicago - -

Agricultural Letter

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CAPITAL REQUIREMENTS of farmers have grown as the size of efficient farms has increased. Not only are the number of acres which can be operated by one person considerably larger today than even a decade ago, but also the cost per acre is much higher. And when the investment in the additional buildings, machinery and equipment for an efficient farm is added to the investment in land, the capital needs become quite large for most types of farms.

Typically, agriculture is financed largely by equity capital; only about 11 per cent of the value of total farm assets is represented by credit. But for individual farmers, especially those who are becoming established or must enlarge their business substantially to keep abreast of technological changes, large amounts of additional funds may be needed.

Farm real estate mortgages are available, typically in amounts equal to no more than half of the purchase price of land. A variety of financial institutions provide credit to finance farm machinery and equipment purchases and current operating expenses, as well as family living expenses while a crop is produced. Also, many merchants provide credit to farmers in an effort to boost their sales.

All of this, of course, is well-known, as are the effects of the growing size of farms on capital needs. While many may feel that there are shortcomings or inadequacies in the present credit facilities available to agriculture, a more basic problem arises in providing the equity or risk capital necessary to finance a farm business—the capital which is not provided on a credit basis because of the relatively risky nature of farming. The problem consists of two parts: (1) capital to establish efficient farms and (2) financing transfers of ownership of efficient farms.

IMPORTANT LEGISLATION which at least indirectly bears on this problem received Congressional approval at the last session. Under the Technical Amendments Act of 1958, certain small business corporations including farms may elect to be treated essentially as a partnership for income tax purposes. These tax provisions allow the shareholders of the corporation to be taxed on the income of the corporation without the corporation having to pay a separate corporation income tax.

The significance of the new law for farm business is: first, that the major disadvantage of incorporating—double taxation of corporation income—has been removed for the small, "family" corporation; second, where such corporations have losses over several years that cannot be offset against taxable income at the corporate level, shareholders benefit since they can now offset these losses against their individual incomes. Of course, this loss offset has no advantage where all the income is derived from the business. However, a farm business may now have greater ability to attract outside equity capital through the device of a small corporation.

THE ADVANTAGES of the corporate form of business are well-known: limited liability, ease of transfer of ownership by a shareholder, ability to continue operation after death of an owner, improved credit status, a tax advantage for fringe benefits (such as health insurance, retirement plans) which are not taxed when paid by a corporation and a lower tax rate for individuals in high personal income tax brackets. (Corporation taxes are at the rate of 30 per cent on income under $25,000 and 52 per cent over $25,000 whereas personal income taxes reach a 30 per cent rate between $12,000 and $16,000 and go much higher in the high income brackets.)

The disadvantages of a corporation include: the initial cost of incorporating, the costs and inconvenience of complying with regulations concerning corporations and, prior to the new law, the disadvantage of the double taxation of income first to the corporation and then on the dividends paid by the corporation. Of course, the tax disadvantage was inoperative where all the income of the corporation was paid out as salaries to the owners. However, such a payment prevents accumulation of earnings in the corporation and possible shifting of ordinary income to capital gains which is taxed at no more than half the ordinary tax rate.

THE FEDERAL ESTATE TAX has also been changed. Where a large proportion of the assets of an estate is in a closely held business, the tax may be paid over a period up to 10 years with interest on the balance at 4 per cent. This means fewer farms will have to be sold to meet estate taxes upon the death of the owner since the earnings from the estate will help meet the estate tax over the period of the tax instalments. This tax deferral is limited, however, to the proportion of the estate tax attributable to the value represented by the closely held business.

ADDITIONAL DEPRECIATION may now be taken on new purchases of machinery. For new or used tangible personal property purchased during the year, the new tax law allows an extra 20 per cent first-year allowance for depreciation in addition to the regular allowance. To qualify for this allowance, the property must have a remaining useful life of at least six years and the allowance is limited to property costing no more than $10,000 ($20,000 on a joint return).

Research Department

FARM BUSINESS CONDITIONS

September 1958, with comparisons

ITEMS	1958 September	1958 August	1957 September
PRICES:			
Received by farmers (1947 - 49 = 100)	95	93	90
Paid by farmers (1947 - 49 = 100)	122	122	118
Parity price ratio (1910 - 14 =100)	85	83	83
Wholesale, all commodities (1947 - 49 = 100)	119	119	118
Paid by consumers (1947 - 49 =100)	124	124	121
Wheat, No. 2 red winter, Chicago (dol. per bu.)	1.87	1.83	2.15
Corn, No. 2 yellow, Chicago (dol. per bu.)	1.28	1.36	1.27
Oats, No. 2 white, Chicago (dol. per bu.)	.62	.65	.74
Soybeans, No. 1 yellow, Chicago (dol. per bu.)	2.21	2.27	2.33
Hogs, barrows and gilts, Chicago (dol. per cwt.)	20.43	21.39	19.34
Beef steers, choice grade, Chicago (dol. per cwt.)	26.70	26.11	24.98
Milk, wholesale, U.S. (dol. per cwt.)	4.29	4.06	4.46
Butterfat, local markets, U.S. (dol. per lb.)	.59	.58	.59
Chickens, local markets, U.S. (dol. per lb.)	.16	.17	.17
Eggs, local markets, U.S. (dol. per doz.)	.41	.37	.40
Milk cows, U.S. (dol. per head)	217	212	171
Farm labor, U.S. (dol. per week without board)	--	42.75[a]	42.50[a]
Factory labor, U.S. (dol. earned per week)	85.17	84.35	82.99
PRODUCTION:			
Industrial, physical volume (1947 - 49 =100)	137	136	144
Farm marketings, physical volume (1947 - 49 =100)	146	131	133
INCOME PAYMENTS:			
Total personal income, U.S. (annual rate, bil. of dol.)	358	356	351
Cash farm income, U.S. [1] (annual rate, bil. of dol.)	--	36	34[b]
EMPLOYMENT:			
Farm (millions)	6.2	6.6	6.5
Nonagricultural (millions)	58.4	58.7	59.2
FINANCIAL (District member banks):			
Demand deposits:			
Agricultural banks (1955 monthly average = 100)	106.9	104.8	101.4
Nonagricultural banks (1955 monthly average =100)	100.6	102.9	99.4
Time deposits:			
Agricultural banks (1955 monthly average = 100)	122.3	121.6	111.2
Nonagricultural banks (1955 monthly average =100)	122.7	122.7	111.2

[1] *Based on estimated monthly income.*

[a] July   [b] August

Compiled from official sources by the Research Department, Federal Reserve Bank of Chicago