FARM BUSINESS NOTES

Prepared by the Divisions of Agricultural Economics and Agricultural Extension
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Planning to Prepare the Income Tax Report

G. E. TOBEN

Most every Minnesota farmer will be required to file a Federal Income Tax report for the year 1942. This report must be filed whenever the gross income equals or exceeds the personal exemption which is $1,200 for a married, and $500 for a single, individual.

The information regarding the farm business should be reported on Form 1040F, "Schedule of Farm Income and Expense," and filed in conjunction with Form 1040, "Individual Income Tax Return." If the farm is operated under a partnership arrangement it will also be necessary to prepare and file Form 1065, "Partnership Return of Income."

University Farm Radio Programs

HOMEMAKERS' HOUR—10:45 a.m.

UNIVERSITY FARM HOUR—12:30 p.m.

THE FRIENDLY ROAD—1:00 p.m.

Station WLB—770 on the dial

A farmer may keep his records and file his returns on either (1) the cash or (2) the accrual method of accounting. Once a method is adopted it must be followed consistently in subsequent years unless written permission to make a change is obtained from the Commissioner of Internal Revenue. Application for permission to change should be made within 90 days after the beginning of the taxable year to be covered by the return.

Comparison of the Cash and Accrual Methods

The two most important differences between the cash and the accrual methods are (1) when the cash method is used the receipts and expenses are reported in the year the cash is received or paid, whereas, with the accrual method the receipts and expenses are reported in the year the transaction occurs whether or not the payment is made; and (2) when the cash method is used the gross farm profit is the cash receipts from products sold for cash or traded for merchandise; while with the accrual method, the gross farm profit is based on the receipts from products sold or traded, with adjustments for inventory changes. (For example, with the cash method, crops produced in 1942 and sold in 1943 are not reported as income until 1943; if the accrual method is used the crops are reported in inventory and considered as income in 1942 at the December 31, 1942, price.)

There are two major advantages in using the cash method. (1) Tax payments are not made on inventory increases that have not yet been converted to cash; therefore, money income will always be received in the year for which tax payments are due. (2) An advance cash purchase of products, to be used in the next year's production, made near the close of a year when income is unusually large will reduce the amount of the tax that year. However, with no change in the tax rate, this will increase the total amount of the tax in the following year unless the income in the second year is small.

There are four major advantages in using the accrual method. (1) Less time is required to prepare the statement when the farmer buys and sells considerable numbers of livestock. Only the total number and value of the beginning inventory, ending inventory, purchase, and sale of each class of livestock need be reported on the accrual basis. On the cash basis it is necessary to separate the sales of livestock raised from livestock purchased; it is also necessary to separate the sales, depreciation claim, or death loss on purchased livestock for each purchased animal if they were purchased in different years, at different ages, or different costs. (2) Over a period of years the total tax paid by a farmer may be less if his physical inventory of crops, livestock, or products shows considerable fluctuation from year to year. This is true if the amount of the change shifts the surtax net income into a taxable bracket or a different surtax bracket, thus increasing or decreasing the tax rate. (3) Installment receipts are reported in the year of the transaction rather than the year the cash is received. By this method the income that may accrue from an installment receipt is more apt to be taxed in the year that claim is made for the expense of producing the product. (4) The accrual method avoids a heavy tax payment when the operator quits farming and sells his personal property. With the cash method, the gross sale value of all livestock, crops, and products produced on the farm is subject to tax in the year of sale; whereas, with the accrual method, only the increase in value from the beginning inventory of the year to time of sale is subject to tax.

In 1941 the cash method was used by 174 farmers and the accrual method by 82 of the 256 farmers in Minnesota farm management services who answered a questionnaire on the use of instructions for "Preparing the Income Tax Return from Records Kept in the Minnesota Farm Account Book." Of this number, 22 indicated they were planning to change to the accrual method in 1942. An additional 23 wanted to change, but failed to make application before April first. Only one farmer indicated an intention to change from the accrual to the cash method.

Farm Accounts Reduce the Work and the Tax

A good farm record saves time in preparing the income tax report because all of the information regarding farm income and all evidence of farm expenses are assembled in one place. With a good record it is unnecessary to secure evidence of income and expense from all individuals with whom business was done. The more complete the account book, the easier it is to prepare the report. With an account book designed to classify all items of expense and income at the time the entry is made, a farmer can prepare his report by entering the totals from the record directly on the tax statement.

A good record not only saves time in preparing the tax report, but also may reduce the amount of the tax payment. Most farmers have a small number of relatively large items of income which can be remembered, but usually have a large number of small expenses which are difficult to remember. The individual items of expense, small sums in themselves but important in the aggregate, aid in reducing the amount of tax payment. The government expects payment of the proper tax, but no more.

Preparing the Report

The method of determining gross farm profit is indicated in paragraph four. With either method, the deductions include the farm expenses, depreciation of property used in production, and deductible losses.

All the necessary amounts of actual money outlay for items which are normally consumed during the year (feed, taxes, etc.) should be reported as farm expenses. The amount spent for new and major repairs on buildings, machinery, and equipment is not reported as an expense in the year incurred. The cost of these items is distributed over a period of years by means of an annual depreciation. The cost of livestock is handled in the same manner when such livestock is reported in the depreciation section. The cost of other livestock purchased is recovered at the time of sale or through death loss when the cash method is used. With the accrual method the cost is reported as a purchase if such livestock is reported in inventory.

Depreciation

Depreciation is the decline in value of property due to use, wear, exhaustion, and the normal effect of increasing age. It is the method of recovering the purchase price of buildings, machinery, equipment, draft animals, and breeding livestock as an expenditure. With either the cash or the accrual method, claim cannot be made in the depreciation section for livestock or products not purchased. Under the accrual method, purchased work animals and breeding livestock may be reported either in the inventory or in the depreciation section; however, it is usually more convenient to report purchased livestock in inventory with all other livestock. Do not report in both places. Depreciation and expenses on the operator's dwelling are not allowable deductions as they are not business expenses.

Depreciation occurs over the life of an item; therefore, it must be allotted to past years even though returns were not filed. Annual depreciation is determined by dividing the original cost of the item by the estimated useful life in years. Calculate the depreciation at a constant rate from year to year, unless (1) a major repair is made which will prolong the useful life, or (2) it becomes evident that the useful life has been underestimated. In either case the estimated remaining life may be increased, but not decreased.

The original cost of a building, machine, or piece of equipment is the total amount paid for the item if a similar kind of old equipment was not traded for the new one. If a trade were made, the original cost of the new item is the difference paid on the trade added to the depreciated value of the old machine. Then depreciation of the new item is calculated from this level. This adjustment is necessary because the regulations specify that a gain or loss on any of these items traded for a similar kind of new equipment is adjusted in the cost of the new item; the gain or loss is not reported as income or expense. On the other hand, if one of the above items is sold outright (not traded) for more than the depreciated value, enter the difference as income; if it is sold for less than the depreciated value, report as an expense.

Losses

Both farm and personal losses incurred during the year are deductible from gross income as expenses if they are due to the elements, result from an accident, or other nonintentional destruction. The amount of the loss that may be claimed is the original cost less (1) depreciation allowed or allowable for prior years and (2) any insurance indemnity received. If the indemnity exceeds the depreciated value, the difference is reported as an income. If an item is damaged, claim can be made for the extent of the loss. Only death losses of purchased livestock (not livestock raised) are deductible with the cash method; with the accrual method, the only death losses allowable as expenses are livestock that would have been reported in the depreciation section. Losses of anticipated profits or of farm products which have never been reported as income are not deductible unless reflected in inventory change when the accrual method of reporting is used.

Minnesota State Income Tax

Minnesota has a State Income Tax entirely separate from the Federal Income Tax. Most of the previous discussion on the Federal Tax applies to the State Tax.

Zoning and Pooling Plans to Reduce Creamery Truck Mileage

E. Fred Koller

As a war measure designed to conserve tires and trucks the Office of Defense Transportation has recommended that industry transportation committees be set up to prepare transportation conservation plans for their areas. In accordance with this recommendation, creamery industry groups in various parts of Minnesota are meeting to consider ways of reducing creamery truck mileage. Among the most difficult problems confronting these groups is that of eliminating the excessive overlapping of the routes of neighboring creameries.

Among the more comprehensive plans of dealing with the problem of overlapping routes are the (1) zoning and (2) pooling plans which are receiving considerable attention. Under the *zoning plan* creameries are assigned definite supply areas or zones near their plants to which their truck operations are to be restricted. A creamery is given the exclusive right to operate cream trucks in its zone thus eliminating the problem of overlapping routes and wasted mileage. The zones may be established on the basis of (1) a majority vote of patrons in an area, (2) proportion of butterfat obtained over a period of time, or (3) the amount of butterfat needed for most efficient plant operation. Provisions should be made to allow changes in zone boundaries at designated intervals in the event a considerable number of patrons desire to change outlets. It is important to include this feature in the zoning plan to avoid the perpetuation of inefficient creameries. A major disadvantage of the zoning method is that it greatly limits the farmer who relies on truck assembly in the choice of a creamery and it limits the creamery's selection of patrons.

Under the *pooling plan,* or hauling area plan, all trucks over an area such as a county are assigned exclusive territories by a truck pool committee or some other authority. The territory assigned to a truck should be compact and large enough for the most efficient operation of the truck. In this area the hauler will collect the cream of all the patrons and for all creameries. The butterfat thus assembled will be delivered to the nearest or predominant creamery in the area or other desirable concentration points along his route. There the appropriately marked cans will be picked up by the other creameries to which some of the farmers desire to sell their product. The significant feature of this plan is that the cream haulers merely provide a transportation service corresponding to that of a commercial truck or dray line. They take no part in inducing farmers to patronize a certain creamery or in determining its trade area as under present methods. As in the case of the zoning arrangement, the important advantage of this plan is that it provides for the elimination of duplicated cream routes thus reducing truck mileage greatly. Furthermore, the plan has additional merit in that it gives the farmer greater freedom in selecting his creamery. In this way the continued development of the more efficient creameries is not handicapped.

Creamery groups which enter into voluntary associations to reduce the overlapping of cream truck routes under either the zoning or pooling arrangement must submit a statement of their plan to the regional Office of Defense Transportation (Minneapolis) for approval. The Office of Defense Transportation will in turn clear through the Department of Justice to insure compliance with the antitrust laws.

It Is Time to Think About Farm Accounts

S. A. Engene

A good set of records can be very valuable to a farmer. It can save time when preparing an income tax report. It can also make possible a more accurate report, which is important now when personal exemptions are low and tax rates are high. It can provide the information needed for the preparation of net worth and operating statements that are valuable aids in obtaining or renewing loans and maintaining the support of creditors. It can also provide the information needed for a thorough analysis of the farm business. Such an analysis will indicate sources of profits and losses and possible improvements to increase earnings in the future.

Careful study should be given to the selection of a suitable book. Since the record is kept to provide information for future use the book should be so arranged that the information can be easily obtained when needed. Consider the following points when selecting a book.

1. It should be prepared by workers who have had long experience with the accounting problems of farmers.
2. It should provide forms for recording all types of information that will be needed, such as inventories, purchases, and sales for the preparation of income tax and credit statements, and records of crops raised, livestock births and deaths, farm produce used in the home, etc., for analysis.
3. It should provide for detailed classification of the entries. Although a book which is classified in considerable detail may appear more complicated, it is in fact easier to use and far more valuable than one with little classification. If the items are not classified at the time of entry they must be recopied and classified before they can be used. This involves extra work and prevents the farmer from obtaining worthwhile information from the record until he has time to prepare a summary.
4. It should provide space for the description of each item in order that it may be identified when summaries are prepared.
5. It should provide space for all essential entries.
6. It should provide clear and adequate instructions for the guidance of farmers who have little time to become familiar with accounting methods.

A large number of farm account books are available. Most state agricultural experiment stations and extension divisions have prepared account books adapted to conditions within their states. Most of these books have been prepared on the basis of years of experience with farm accounting problems. They provide the information needed by the farmer in a form that is convenient.

The Minnesota Farm Account Book has been developed to meet the needs of Minnesota farmers. It is based upon years of cooperation with farmers in keeping and analyzing records. It fulfills the requirements of an adequate farm record book. It is easy to keep and provides a record in a usable form. This book is available at the county agents' office or at the Students' Bookstore, University Farm, St. Paul.

Minnesota Farm Prices For October, 1942

Prepared by W. C. Waite and H. G. Hirsch

The index number of Minnesota farm prices for October, 1942, was 151. The index numbers for the three classes of farm products were: crop prices 126, livestock prices 165, and livestock product prices 149.

The price index of 151 for the past month is the net result of increases and decreases in the prices of farm products in October, 1942, over the average of October, 1935-39, weighted according to their relative importance.

Average Farm Prices Used in Computing the Minnesota Farm Price Index, October 15, 1942, with Comparisons*

	Oct. 15, 1942	Sept. 15, 1942	Oct. 15, 1941		Oct. 15, 1942	Sept. 15, 1942	Oct. 15, 1941
Wheat	$ .99	$ .98	$ .90	Cattle	$11.80	$11.30	$6.78
Corn	.68	.71	.53	Calves	12.70	12.70	8.28
Oats	.36	.37	.25	Lambs-Sheep	11.46	11.62	7.70
Barley	.54	.55	.52	Chickens	.16	.18	.12
Rye	.48	.52	.48	Eggs	.32	.31	.22
Flax	2.24	2.23	1.72	Butterfat	.49	.45	.31
Potatoes	.85	.80	.48	Hay	5.00	4.50	5.02
Hogs	14.10	13.50	8.56	Milk	2.30	2.15	1.68
				Wool†	.39	.39	.25

* These are the average prices for Minnesota as reported by the United States Department of Agriculture.

† Not included in the price index number.

The Minnesota farm price index has risen by 12.6 points from September to October. Such a jump has not occurred in many years. It is only partially due to actual price rises. Hogs, cattle, and butterfat, the three most important commodities, have indeed increased in price. However, another reason for the jump is that hogs and cattle are given more weight in the October index than in September, due to their heavier marketings, so that these together with butterfat become more important than all other 13 commodities combined, while in September, hogs, cattle, and butterfat were not weighted so heavily.

A slight decline of most grain prices and the rise in hog, beef, butterfat, and egg prices resulted in a widening of all feed ratios. A hog-corn ratio of 20.7 is well above the ratio at which hog production usually expands.

Indexes and Ratios for Minnesota Agriculture*

	Oct. 15, 1942	Sept. 15, 1942	Oct. 15, 1941	Average Oct. 1935-39
U. S. farm price index	158.2	150.4	130.1	100
Minnesota farm price index	150.7	138.1	118.2	100
U. S. purchasing power of farm products	126.8	122.9	118.8	100
Minn. purchasing power of farm products	120.7	112.8	107.9	100
Minn. farmers' share of consumers' food dollar	58.6	57.3	53.2	47.6
U. S. hog-corn ratio	18.2	16.4	15.5	14.1
Minnesota hog-corn ratio	20.7	19.0	18.7	17.8
Minnesota beef-corn ratio	17.4	15.9	16.7	14.7
Minnesota egg-grain ratio	23.7	22.3	23.7	20.9
Minnesota butterfat-farm-grain ratio	42.7	37.8	38.0	36.4

* Explanation of the computation of these data may be had upon request.

Price Control in 1942

The Emergency Price Control Act which was passed in January, 1942, provided authority for fixing prices of commodities in the United States. Two important exceptions to complete control were made in the Act. There were no controls over wages, and the Administrator's power to set ceilings on prices of farm products was definitely limited. In May the General Maximum Price Regulation was issued by Office of Price Administration under the authority granted by the original Act. This regulation returned retail and wholesale prices of nearly all commodities, on which prices could be fixed, to their March, 1942, level and prohibited increases above these March levels except in special circumstances. These regulations appear to have been successful in curtailing the general rise in prices, the Bureau of Labor Statistics Index of Wholesale Prices standing at 123 in September as compared with 121 in March. Wages and agricultural prices, however, continued to rise relative to the controlled prices. The ratio of prices received by farmers for commodities sold, to the price of commodities bought by them, rose from 97 in March to 107 in September. This rise in agricultural prices was reflected in an increase in food costs in cities, the Bureau of Labor Statistics Index of Retail Food Costs rising from 118 in March to 127 in September. This rise in food costs was in turn largely responsible for an increase in the index of the cost of living in cities from 114 in March to 118 in September. Wages also increased, the average hourly rate reported by the Bureau of Labor Statistics for all manufacturing industries rising from 80.9 cents per hour in March to 86.4 cents in August. The price controls placed on the majority of commodities, together with no controls on wages and limited controls on agricultural products, thus resulted in a relative improvement in the price situation for these latter groups between March and September. The Amended Price Control Act of October 2, 1942, has changed the situation, principally by making wages and agricultural prices subject to price controls.

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