FARM BUSINESS NOTES

Prepared by the Divisions of Agricultural Economics and Agricultural Extension
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Income Tax Rates and Farm Investments

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Effects of existing income tax rates and regulations on investors in farm real estate, purebred livestock, and other farm capital vary according to size of income. Those with small incomes are permitted to retain a higher proportion of current income and capital gains than those with large incomes, while those with large incomes are able to recover a higher proportion of major capital losses and depreciation. These widely varying economic effects have an important bearing upon the competitive position of investors in farm capital.

Table 1 illustrates this for individuals at three widely varying income levels. It is assumed that A has a small income all from the farm operated by himself; B has a medium income largely from other sources than the farm; while C has a large income to which his farm contributes a very minor part. Each is assumed to be married and to have two dependents.

Table 1. Some Effects of Graduated Tax Rates on Minnesota Farm Investments by Individuals at Various Income Levels*

	Size of income		
	A Small	B Medium	C Large
Nonfarm taxable income	$ 0000	$30,000	$300,000
Returns to farm capital and management	3,000	3,000	3,000
Gross income tax income	4,000†	33,000	303,000
Gross victory tax income	4,030‡	33,000	303,000
Total income and victory taxes on normal income	482	14,424	246,485
Per cent of income tax income remaining after payment of normal income and victory taxes	88	56	19
Per cent of capital gain retained if farm is sold for gain of $16,000:			
Six months or less after purchase	60	32	11
More than six months after purchase	80	62	50
Per cent of capital loss recovered through reduction in tax if farm is sold for loss of $16,000	3	58	89
Per cent of $10,000 invested in purebred livestock recovered through depreciation	24	65	93

* Data are based upon tax rates in effect December 31, 1943.

† Includes $3,000 return to capital and management, $900 for the operator's labor, and $100 for the depreciation and upkeep of dwelling.

‡ The victory tax for A is increased by the real estate tax on the dwelling, which is estimated at $30.

A is permitted to retain 88 per cent of the taxable income from his normal farm operations, while B is permitted to retain 56 per cent of his farm and nonfarm taxable income, and C only 19 per cent (table 1). The larger the income the higher the proportion of normal taxable income required to pay income and victory taxes.

All capital gains arising out of the sale of farm real estate are subject to tax graduated according to income if sold six months or less after purchase; but if not sold until after the six-month period has elapsed, the seller is permitted to retain 50 per cent of the profit tax-free regardless of size of income. The remaining 50 per cent is subject to tax. If the farms owned by A, B, and C are sold at $16,000 profit each within six months after purchase, A is permitted to retain 60 per cent of the gross capital gain, B 32 per cent, and C only 11 per cent. But if not sold until after the six-month period has elapsed, A retains 80 per cent of the resale profit, B 62 per cent, and C 50 per cent. Thus, those with small incomes retain a much higher proportion of resale profits than those with large incomes, but the relative difference is less for long-time than for short-time gains.

On the other hand, if the farms owned by A, B, and C are sold at a loss of $16,000 each, and if the resulting reduction in tax is credited to the capital loss, A recovers only 3 per cent of the loss through decreased income and victory taxes, B 58 per cent, and C 89 per cent. The actual loss is almost complete for A, but decreases with rising income until it becomes relatively unimportant for C.

Similar effects arise from investments in purebred livestock. If A, B, and C each invests $10,000 in a foundation herd of purebred livestock, and the period of depreciation for income tax purposes is 10 years, A will recover 24 per cent of the original cost during the 10-year period, B 65 per cent, and C 93 per cent. Thus, the price paid for the animals is a matter of less concern for those with large than for those with small incomes.

The same general principles apply with respect to investments in other types of depreciable farm capital, such as grade breeding stock, commercial dairy cows, farm buildings, and machinery. Those with large incomes can invest in such items with less regard to the original cost than those with small incomes. A serious decline in sale prices would have little effect on those with large incomes, but would be disastrous for those with small incomes operating largely on borrowed capital.

It is apparent that, under existing regulations, investments in farm real estate serve as a partial protection against inflation for buyers at all income levels providing sale values rise further after purchase and either remain at a higher level or the farms are sold before the boom breaks and full payment received. The protection is more complete for those with small than for those with large incomes. On the other hand, those with large incomes are assured of a relatively small loss on the investment if land values drop, as long as the gross loss from the sale of the farm is small compared with total taxable income. As the level of income declines, the amount of the loss increases until it becomes almost complete for the average farmer or others with relatively small incomes. Consequently, the purchase of farms at inflated prices may not prove disadvantageous to those with large incomes either in the short or long run, but it is likely to prove disastrous to those who make small down payments and expect to pay the balance out of future farm earnings.

The purchase of farms by outside investors is of interest for two reasons. In the first place, it contributes to the land boom which is now under way in many parts of the country. In the second place, the purchase of farms by nonfarmers is likely to result in an increase in the proportion of farms operated by tenants or with hired labor.

Regardless of the relative efficiency of owner-operated and tenant-operated farms and regardless of relative security of tenure, past public policy suggests that the acquisition of large acreages of farm land during the war and early postwar period by outside investors may not meet with general approval. Many tenants look forward to buying farms, and there is likely to be considerable demand for farms by those in the armed services and by others who have left farms temporarily to work in war plants.

In like manner, the purchase of purebred livestock by large income receivers contributes to the purebred livestock boom which is now under way. Even though they limit their selections to animals that stand in highest repute among members of the fraternity, the result is higher prices all along the line. Those with low incomes may purchase a few superior animals in competition with their more favorably situated brothers, but, on the whole, they will be obliged to limit their purchases to animals that are assumed to be somewhat less meritorious. As they listen to the chant of the auctioneer, they must keep constantly in mind the fact that the real cost of a high-priced purebred animal will be much less for those with large than for those with small incomes.

In some respects, a purebred cattle boom is less serious than a land boom. Boom prices for a few animals usually represent a smaller total investment than a boom price for a farm. A cattle boom is liquidated rather promptly, while the effects of a land boom may carry over the greater part of a generation. However, both are highly undesirable, and when one is superimposed upon the other, the results are bound to be disastrous for many.

Existing tax regulations tend to encourage some persons with large incomes not only to invest in farm real estate, purebred livestock, and other forms of farm capital, but to make expenditures which otherwise would not be incurred because of the relatively small equities they have in their taxable incomes. This raises a question whether society will be best served in the long run under the existing arrangements or whether some modifications are called for. If it is decided that the general welfare will be best served by discouraging investments in farm capital by those with large incomes and by discouraging speculation in farm properties by others, attention will need to be focused upon ways and means of reaching these objectives. One possible approach would be to prohibit the deduction of capital losses and depreciation of farm capital from farm and nonfarm income combined before computing the tax. Elimination of the regulation whereby 50 per cent of the capital gains is exempt from tax if the sale takes place more than six months after purchase also would contribute to this end. To remove the inflationary pressure on land values by those with small incomes it may be desirable to adopt a stiff capital gains tax until after the emergency has passed.

The Farmer's 1943 Income and Victory Tax Returns

G. E. Toben

Practically all farmers in Minnesota will have to file a federal income and victory tax return for 1943. This regular complete return for the calendar year is due on or before March 15, 1944. If the return is for some period other than the calendar year, it must be made on or before the 15th day of the third month following the close of the tax year.

Married persons whose gross income exceeds $624 and single persons, or those married and not living with their wife or husband, with gross income over $500, must file a federal return. The preparation of an estimated declaration (usually submitted Dec. 15) or the withholding of tax through payroll deductions does not excuse individuals from submitting this complete and accurate return after the close of the year.

Many Minnesota farmers also will have to file a state income tax return. According to the state law a return must be filed if a tax is due or if the gross income exceeds $5,000. In general, most married individuals whose net profit exceeds $2,000 or single individuals whose income exceeds $1,000 will have to prepare a state return.

In order to assist farmers to prepare their income and victory tax returns easily and without outside assistance, the Division of Agricultural Economics has prepared a Schedule of Income and Expense and a set of instructions. This new schedule is designed to meet both federal and state requirements. Therefore, a copy may be submitted with the return in place of the usual state Form I-1 or federal Form 1040 F.

The arrangement of this schedule conforms to that in the Minnesota Farm Account Book. The schedule also shows the page and column number in the account book from which the data are taken. The same farm schedule may be used with either the complete Minnesota Farm Account Book or the Income Tax Section because the column numbers are the same in both books.

The instructions that accompany the Schedule of Income and Expense explain the use and procedure for preparing this farm schedule. Furthermore, suggestions are also included for calculating the amount of the tax on federal Form 1040 and state Form I-1. These suggestions explain the calculations on the federal "Individual Income and Victory Tax Return" and on the state "Individual Income Tax Return."

If records were not kept during 1943, an account book such as the Income Tax Section will serve as an excellent form for assembling the data. The index in the book will also remind the farmer of items that might be forgotten. It is important to recognize that the Internal Revenue can usually determine the amount of one's income when checking the accuracy of the return. Expenses and other deductions, on the other hand, must be proved by the taxpayer. Since expenses, especially the small amounts, are very easily forgotten, each farmer needs a record.

Further details regarding the preparation of the state and federal return by farmers may be obtained from the instructions that accompany the new Schedule of Farm Income and Expense. Those interested in securing copies of the forms, instructions, or account book may purchase them from the county agricultural agent or from the Agricultural Book Store at University Farm, St. Paul 8.

Farmers' Interest in War Bonds

O. B. JESNESS

The question confronting farmers is not whether they ought to invest in war bonds. Every citizen with an income should lend part of it to the government to help finance the war. The decision which farmers have to make is how large that investment should be. The best general guide is that the amount should be as large as possible. Each individual must determine the amount for his own case. The intent here is to suggest some of the more important points to consider in making the decision.

Farm income plays the leading role in determining how much farmers can invest in war bonds. Farm incomes have increased materially during the war because of higher prices and larger output. Cash income has increased more than cash outlays for most farmers, leaving a larger net income and more for investment. All, or at least a large share, of this increase should go into taxes and war bonds. Farmers might take this as a starting point in deciding how much to buy.

War shortages limit the amount which can be used for new machinery, equipment, and buildings. The result is that more money is available for other investment now and more will need to be set aside for future use. Each farmer can best decide for himself how much money he will need to replace worn-out equipment and to buy additional equipment, both for the farm and the home. It is good business to set aside the required amount and to store it in war bonds until needed.

War prices will not continue indefinitely. There will be years of unfavorable production and low prices as well as favorable years. Some of the current income will come in very handy at times of low returns and should be put aside for such use. Farm people also recognize that some of the present income should be saved for better living, for education of children, for old age, and other future uses. Each family should review its situation and prospective needs in deciding how much to set aside for these purposes.

Should debt payment have priority over investment in war bonds? Again, each farmer should answer in the light of his own situation. Due and pressing debt should be paid. Long-term debt should be reduced, if necessary, to a point where it can be carried. After that, available income may well go into bonds.

Should farmers buy land rather than bonds? Again, the answer depends on considerations best known to the individual. Can he handle the land? Is it priced right? Will it pay for itself at longer-run prices? Buying land may be the right step in individual cases, but any general activity of this nature will add to the speculative land boom. Most farmers will do better to buy war bonds rather than land at present.

Buying bonds is a way for citizens to help hold inflation in check. Investment of current incomes in war bonds by individuals and business concerns reduces the excess spending power in markets for civilian goods. Government borrowing from commercial banks, on the other hand, adds spending power and increases the threat of inflation. This is one reason why the largest possible investment in war bonds by individuals is important. Another reason why such investment is desirable is that it will distribute the holdings and the future income from bonds more widely among citizens.

But may not the bonds fall in value? This question dates from the situation following the last war when for a time liberty bonds sold at a discount. But liberty bonds, unlike present issues bought extensively by individuals, were marketable and carried no provision for redemption at par by the Treasury before they were due.

Buying of war bonds is an investment in the highest type of security available and is in no sense a gift to the government. Their purchase can be described as a sacrifice only to the extent it involves postponement of other use of the money. It is doubtful whether even this can be regarded as a sacrifice in times of war scarcity and higher prices. The money thus saved will be available for use in the future at a time when a greater variety of choices is likely to be available and prices may be lower. Avoiding unnecessary purchases at this time and investing the money thus saved in war bonds will aid the war effort and be of longer-run benefit to the investor. Every farm family should take stock of its own financial situation and invest all it can in war bonds.

Minnesota Farm Prices for December, 1943

Prepared by W. C. WAITE and R. W. COX

The index number of Minnesota farm prices for December, 1943, is 163.7. This index expresses the average of the increases and decreases in farm product prices in December, 1943, over the average of December, 1935-39, weighted according to their relative importance.

Average Farm Prices Used in Computing the Minnesota Farm Price Index, December, 1943, with Comparisons*

	Dec. 15, 1943	Nov. 15, 1943	Dec. 15, 1942		Dec. 15, 1943	Nov. 15, 1943	Dec. 15, 1942
Wheat	$ 1.46	$ 1.38	$ 1.10	Hogs	$12.80	$12.60	$13.20
Corn	.99	.92	.69	Cattle	11.20	11.40	11.50
Oats	.71	.70	.42	Calves	12.40	12.80	12.80
Barley	1.05	1.02	.60	Lambs-Sheep	11.50	11.21	12.29
Rye	1.04	.96	.51	Chickens	.21	.21	.17
Flax	2.85	2.85	2.37	Eggs	.39	.42	.34
Potatoes	1.15	1.00	.90	Butterfat	.53	.53	.51
Hay	8.60	7.10	6.00	Milk	2.85	2.85	2.45
				Wool†	.40	.41	.39

* These are the average prices for Minnesota as reported by the United States Department of Agriculture.
† Not included in the price index number.

The prices of the various crops with the exception of oats, barley, and flax made substantial gains from November to December. The increase in corn prices was due primarily to the higher ceiling price. The prices of hogs and lambs increased somewhat but the prices of cattle and calves declined. The prices of eggs were lower in December than in the previous month, but the prices of the other livestock products remained at their November levels. During the past 12 months, the Minnesota farm price index increased 3 per cent. Although the index of crop prices advanced 48 per cent, the indexes of livestock and livestock products declined about 3 and 5 per cent, respectively.

All of the feed ratios declined from November to December, especially the butterfat-farm grain ratio. The latter is now at its lowest level for December since 1936.

Indexes and Ratios for Minnesota Agriculture*

	Dec. 15, 1943	Dec. 15, 1942	Dec. 15, 1941	Average Dec. 1935-39
U.S. farm price index	185.2	167.3	134.0	100
Minnesota farm price index	163.7	158.9	127.3	100
Minn. crop price index	191.1	128.9	115.3	100
Minn. livestock price index	171.1	176.7	139.5	100
Minn. livestock product price index	141.5	146.9	115.6	100
U.S. purchasing power of farm products	133.5	132.8	116.4	100
Minn. purchasing power of farm products	117.9	126.1	110.2	100
Minn. farmers' share of consumers' food dollar	64.4†	55.6	45.0	46.9
U.S. hog-corn ratio	11.5	16.5	15.3	13.5
Minnesota hog-corn ratio	12.9	19.1	17.6	15.9
Minnesota beef-corn ratio	11.3	16.7	16.0	14.0
Minnesota egg-grain ratio	18.2	22.6	21.9	20.7
Minnesota butterfat-farm-grain ratio	21.4	39.9	31.9	40.4

* Explanation of the computation of these data may be had upon request.
† Figure for September, 1943.

Pig Crop Report December, 1943

Farmers on about December 1 reported to the U. S. Department of Agriculture their intention to have 16 per cent less sows farrow in the spring of 1944 than in the spring of last year. The number of sows farrowing in the fall of 1943 was 12 per cent greater than in the preceding year. Farmers had, however, indicated last spring their intention to have 25 per cent more sows farrow in the fall than in 1942. The smaller actual farrowings than intentions had indicated have been interpreted as resulting from farmers deciding to curtail the hog enterprise. The expected spring decline in farrowings is a further indication of this tendency.

The largest decreases in indicated spring farrowings as compared with a year ago are reported from the South and West and the smallest decreases from the North Atlantic states. The average decrease for the corn belt is the same as for the United States, but is slightly higher, 18 per cent, for Minnesota. The indicated decrease in Minnesota is larger than that of Iowa, Illinois, or Indiana.

The Minnesota and United States hog-corn ratios are not unfavorable and, with record and near record corn crops in many states, hog production would not be expected to decline under normal circumstances. Farmers have apparently been concerned with the difficulties encountered in marketing the record 1943 spring pig crop, the reduced support prices announced for the 1944 spring pig crop, the expectation of higher corn prices, the shortage of high protein feeds, and various other factors which are considered by them to be unsatisfactory.

The combined spring and fall pig crop in 1943 is estimated at about 122 million head for the United States. This exceeds the 1942 pig crop by 17 per cent and is 67 per cent above the average of the 10 preceding years. The Minnesota pig crop for 1943 is estimated to have been 8,653,000 head. Minnesota was the third state in the number of pigs produced in 1943.

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