PURDUE UNIVERSITY

PURDUE AGRICULTURAL ECONOMICS REPORT

NOVEMBER 2009

Indiana's State Budget, 2009-2011 and Beyond

Larry DeBoer, Professor

September 2009

Indiana's General Assembly passed a budget on the evening of June 30, 2009. It took a special session, and the pressure of an end-of-fiscal-year deadline that had not been missed for more than a century, for legislators to agree on a spending plan for 2010 and 2011.

The state budget agency provides plenty of information about the budget's appropriations, revenues and balances. Unfortunately, it's all in separate documents, which makes the big picture difficult to understand. Table 1 draws this information together in "checking account" form. Like any household, the state starts the year with balances, which is money in the bank. The state had $1.4 billion at the start of fiscal 2009, on July 1. We receive state income from taxes and other revenue sources, but not nearly as much as we expected. We write checks to pay for public services, based on appropriations planned in our budget. Our rich but indebted uncle slips us some cash to help out, with the American Recovery and Reinvestment Act stimulus money. We shift some money around, with fund transfers, and cancel some previously planned spending, with reversions. And at the end of the year, we've got money left over, in balances in the bank.

This paper uses the state's budget information in this "checking account" form to look at the state's 2009 budget problem, to understand the choices that the General Assembly made for the 2010-11 biennium, and to project revenues and appropriations for the 2012-13 biennium.

Fiscal Year 2009

Revenues. Revenues were the problem for this budget. Table 1 shows total revenues down $151 million from 2008 to 2009. This was the first year-to-year drop since 2002. The reason, of course, was the recession which began in December 2007, and intensified in the Fall of 2008. This revenue drop understates the recession's effect on the budget. Sales tax revenues increased $467 million because of the hike in the sales tax rate from 6% to 7% in April 2008. The rate was increased during the last three months of fiscal 2008, and for all of fiscal 2009. Without the higher rate, sales tax revenue would have fallen by nearly $200 million.

More important for budgeting is the shortfall of actual revenues below projected revenues. In April 2007 the legislature passed a balanced budget for 2009. Projected revenues more than covered planned spending. Reforms were made in 2008, which replaced property taxes with added state appropriations. The added state spending required by the reform was balanced by an equal amount of anticipated new revenue. Yet, when the books were closed on 2009, revenues had fallen short of appropriations by almost $1.4 billion dollars. That's the amount shown in Table 1 under Current Year Surplus/

In This Issue

Table 1. Indiana State Budget Summary, FY 2008-2011 (millions of dollars, updated through July 2009 budget closeout)

	Actual 2008	Actual 2009	Budget 2010	Budget 2011	Avg. Ann. 2000-09	Change 2009-11
Start of Year Balances	1,286	1,413	1,419	1,334		
Revenues						
Sales Tax	5,686	6,153	6,132	6,438	6.0%	2.3%
Individual Income Tax	4,838	4,314	4,289	4,547	1.6%	2.7%
Corporate Income Tax	910	839	800	819	-1.8%	-1.2%
Gaming	583	621	646	661	0.0%	3.1%
All Other	1,187	1,125	1,322	1,140	3.7%	0.7%
Total	13,203	13,052	13,189	13,606	4.0%	2.1%
Appropriations						
K-12 Education	4,830	6,169	7,584	7,669	5.2%	11.5%
Higher Education	1,654	1,744	1,726	1,756	3.0%	0.3%
Medicaid	1,587	1,664	1,821	1,874	5.3%	6.1%
Property Tax Relief	2,308	1,699	90	-	5.4%	-100.0%
Health & Social Services	943	1,237	1,354	1,354	5.6%	4.6%
Public Safety	721	801	781	796	2.9%	-0.3%
All Other	943	1,122	1,122	1,064	1.2%	-2.6%
Total	12,986	14,436	14,478	14,512	4.5%	0.3%
Current Year Surplus/Deficit	217	(1,385)	(1,289)	(906)		
ARRA Medicaid		405	549	289		
ARRA Fiscal Stabilization		587	276	221		
ARRA Total		992	825	510		
Adjustments						
Transfers from (to) Other Funds	19	73	16	20		
Reversions	133	357	363	50		
Payment Delays (Reversals)	(241)	(31)	-	-		
Total Adjustments	(89)	399	379	70		
End of Year Balances						
General Fund	593	55	185	144		
Tuition Reserve	400	942	721	425		
Medicaid Reserve	58	58	58	58		
Rainy Day Fund	363	365	371	382		
Total	1,413	1,419	1,334	1,008		
Total Balances % of Revenue	10.7%	10.9%	10.1%	7.4%		

Deficit. This is an enormous shortfall of about ten percent of the budget.

Appropriations. State appropriations increased substantially from 2008 to 2009 because of the 2008 property tax reform. In 2009 the state took over the school corporation general funds, county welfare funds, and several smaller local government funds. These had been paid for with property taxes; now they are financed out of the state budget. The reform represents a movement away from property taxes, towards sales taxes, to support local government services.

State appropriations for K-12 education increased more than $1.3 billion as a result of this tax policy change. This does not mean that local school corporations were awash in new money. Each dollar of added state aid replaced a lost dollar of property tax revenue for the schools. Likewise, health and social services spending rose almost $300 million because of the takeover of county welfare funding.

These 2009 spending increases were partially offset by a reduction in property tax relief of more than $600 million. This is also the result of the 2008 tax reform. The old methods of providing tax relief—property tax replacement credits and homestead credits—are being phased out. These were credits that reduced the tax bills of property taxpayers. The state compensated local governments for this lost revenue with payments from its budget. Now, tax relief will be provided by eliminating whole functions from the property tax. The credits will disappear, and the property tax relief money will help pay for the added state spending on schools and welfare. The sales tax increase will also fund these new expenditures.

Purdue Agricultural Economics Report is a quarterly report published by the Department of Agricultural Economics, Purdue University.

Editor
Gerald A. Harrison
Purdue University
Department of Agricultural Economics
403 W State Street
West Lafayette, IN 479072056
E mail: harrisog@purdue.edu
Phone: 765 494 4216 or
toll free 1 888 398 4636 Ext. 44216

Editorial Board
W. Alan Miller
Christopher A. Hurt
Philip L. Paarlberg

Layout and Design
Cathy Malady

Circulation Manager
Angie Flack

Agricultural Economics Department
www.agecon.purdue.edu

PAER World Wide Web
www.agecon.purdue.edu/extension/pubs/paer/

Cooperative Extension Service Publications
www.ces.purdue.edu/extmedia/

Subscription to PAER
Paper copies of the PAER are $12 per year (payable to Purdue University). Electronic subscriptions are free and one may subscribe at: www.agecon.purdue.edu/contact/contact.asp

Purdue University Cooperative Extension Service, West Lafayette, IN
Purdue University is an equal access/equal opportunity institution

Again as the result of the 2008 reform, in calendar year 2008 a temporary tax credit was paid to homeowners, as a bridge between the old and new methods of tax relief. This lessened the reduction of the property tax relief appropriation in fiscal year 2009. By 2011, however, it will be zero. The money will still be providing property tax relief, by paying for the K-12 education and health and social services spending that used to be funded with property taxes.

ARRA: Federal Stimulus Money. ARRA is the American Recovery and Reinvestment Act, the Federal stimulus money passed by Congress in February 2009. There are many stimulus programs, but two were meant to shore up state budgets.

Medicaid is a joint Federal-state program that provides health care for low income people. Each state is expected to finance a fraction of the cost, and the Federal government picks up the rest. In 2009 (and for 2010-11) the Federal government increased its share of Medicaid costs. This reduced the state's spending on Medicaid.

The stimulus bill also included fiscal stabilization funds. These were directed to K-12 education. In 2009 Indiana used this money to make state aid payments to local school corporations, which were owed under the school funding formula. This reduced the state's spending on K-12 education.

Indiana used a total of $992 million in Federal stimulus money in its budget in 2009. It is shown in Table 1 as a separate entry, to make clear how much ARRA money was used in the budget. It could have been counted as reductions in K-12 education and Medicaid spending, making appropriations smaller. Or, it could have been counted as reversions, which are appropriations that are budgeted but not spent, and so revert to the general fund budget. That would have made "adjustments" bigger. That's how the state budget agency counted ARRA money for fiscal 2009.

Adjustments. When budgets are stressed the state often resorts to extraordinary adjustments. In fiscal 2009, $73 million was transferred to the General Fund from other funds, mostly from the Build Indiana Fund. Reversions were by far the biggest adjustment, at $357 million. This was an intentional effort to spend less than the original budget appropriated. When this happens the money reverts to the General Fund. A great many agencies and departments spent less than their appropriations. For example, the State Budget Agency itself reverted $10 million, the Indiana Economic Development Corporation reverted $41 million, and the state's universities, including Ivy Tech, reverted almost $40 million. The amount of reversions in 2009 was probably the most in Indiana state budget history.

Payment delays are an adjustment that was used in the past two recessions. They were not used in 2009, nor were they scheduled for 2010 or 2011. These are delays in payments from the state to local governments, from one fiscal year to the next. This works because the state is on a July to June fiscal year, while local governments are on a calendar fiscal year. If the state delays a property tax relief payment from June to July, the locals get their money during their budget year (just a little late), but the state reduces its recorded spending in the earlier year. This helps maintain balances while reducing the need for spending cuts or tax increases.

This is an accounting trick, a "fiscal gimmick", but it's been useful in the past. It was used after the 1990-91 recession and after the 2001 recession. In each case the payment delays were reversed during the expansions that followed the recessions. Reversals add to a budget's spending. The last payment reversal from the 2001 recession was made in 2009—that's the negative $31 million shown in Table 1.

It seems unlikely that payment delays will be used in the near future. The Governor has pledged not to use this gimmick. Property tax relief payments to local governments are being eliminated, and this was one of the primary payments that were delayed in the past. In addition, school corporations are scheduled to move to a July to June fiscal year, which means a payment delay in state aid to local schools would create a shortfall in their budgets.

End-of-Year Balances. Start-of-year balances, plus revenues, less appropriations, plus ARRA money, plus adjustments, equal end-of-year balances. The state ended the fiscal year with that same $1.4 billion in balances that it had at the start, despite the $1.4 billion shortfall in revenues. It accomplished this by using about one billion dollars in Federal stimulus money, and about $400 million in reversions and fund transfers. Federal dollars plus reversions plus transfers covered the 2009 shortfall, and left the state with money in the bank.

The state budget agency defines the "prudent range" for balances at 10% to 12% of total revenues. This is enough to cover the revenue shortfall in a mild recession for a year. Balances remained in this prudent range in 2009.

Total balances are composed of several sub-categories. The famous Rainy Day Fund makes up $365 million of the total. There is also a small reserve to cover potential shortfalls in revenue for Medicaid entitlement payments.

In 2009, more than $500 million was shifted from the general fund balance to the tuition reserve balance. This was done as a result of the 2008 tax reform. School corporations are now totally dependent on state aid to finance their general funds, which are mostly teacher pay and benefits. It is sensible to build a fund to support these aid payments in the event of revenue shortfalls. Unfortunately, the new school funding policy started in the very year that enormous revenue shortfalls occurred. The tuition reserve balance was increased by depleting the general fund balance.

It's total balances that count, however. The legislature shifted money from the general fund to the tuition reserve fund in 2009. If necessary, it could shift the money right back.

The New Biennium

Revenues are projected to grow slowly in the next biennium, starting from the reduced 2009 level. The 2.1% average growth per year is about half the average growth of the previous decade. As a result appropriations are scheduled to grow slowly. Table 1 shows appropriations increasing only 0.3% a year in 2010 and 2011. In total the budget is almost flat-lined.

K-12 education shows large increases in fiscal 2010, but again this is because of the 2008 property tax reform. Calendar year 2009 is the first year that the state will pay the entire school general fund. For the state, the new payments are split between fiscal year 2009 and fiscal year 2010, which is why it appears to take two years to switch to the new funding policy. In 2008, before the policy change, K-12 education accounted for 37% of state general fund spending. In 2010, the share will be 52%. More than half of all state general fund appropriations

Table 2. Three Scenarios for Indiana's State Budget in the 2012-13 Biennium

	Actual	Budget		Projections		Percent Change	
	2009	2010	2011	2012	2013	2009-11	2011-13
Scenario 1. Business as Usual Budget and Normal Revenue Growth 2012-13							
Start of Year Balances	1,413	1,419	1,334	1,008	188		
Revenues	13,052	13,189	13,606	14,150	14,716	2.1%	4.0%
Appropriations	14,436	14,478	14,512	15,040	15,587	0.3%	3.6%
Current Year Sur-plus/Deficit	(1,385)	(1,289)	(906)	(890)	(871)		
ARRA Federal Stimulus	992	825	510	-	-		
Total Adjustments	399	379	70	70	70		
End of Year Balances	1,419	1,334	1,008	188	(613)		
Total Balances % of Revenue	10.9%	10.1%	7.4%	1.3%	-4.2%		
Scenario 2. Business as Usual Budget and Rapid Revenue Growth 2012-13							
Start of Year Balances	1,413	1,419	1,334	1,008	664		
Revenues	13,052	13,189	13,606	14,626	15,723	2.1%	7.5%
Appropriations	14,436	14,478	14,512	15,040	15,587	0.3%	3.6%
Current Year Sur-plus/Deficit	(1,385)	(1,289)	(906)	(413)	136		
ARRA Federal Stimulus	992	825	510	-	-		
Total Adjustments	399	379	70	70	70		
End of Year Balances	1,419	1,334	1,008	664	870		
Total Balances % of Revenue	10.9%	10.1%	7.4%	4.5%	5.5%		
Scenario 3. Flatlined Budget and Normal Revenue Growth 2012-13							
Start of Year Balances	1,413	1,419	1,334	1,008	716		
Revenues	13,052	13,189	13,606	14,150	4,716	2.1%	4.0%
Appropriations	14,436	14,478	14,512	14,512	14,512	0.3%	0.0%
Current Year Sur-plus/Deficit	(1,385)	(1,289)	(906)	(362)	204		
ARRA Federal Stimulus	992	825	510	-	-		
Total Adjustments	399	379	70	70	70		
End of Year Balances	1,419	1,334	1,008	716	990		
Total Balances % of Revenue	10.9%	10.1%	7.4%	5.1%	6.7%		

will go for local schools. This may imply that schools will be more vulnerable to recessions and expansions in the future. When state revenues fall short, school spending must be cut, because that's where the money is. School spending will grow only when state revenues grow.

Property tax relief disappears from the state budget as of 2011. That's when the last of the temporary homestead credits run out. Tax relief will be provided by reduced property tax levies, due to the state takeovers, by a large added deduction from homestead assessed values, and by the "circuit breaker" property tax caps.

Medicaid appropriations also grow substantially in 2010 and 2011. Medicaid is an entitlement, and so its spending depends on how many people are eligible for care, and what that care costs. With the recession, more people are eligible. And health care costs continue to rise rapidly.

In both years the state plans to spend more than it collects from its own revenue sources, by almost $1.3 billion in 2010, and $900 million in 2011. In 2010, this shortfall again is covered by Federal stimulus money, and reversions. Balances are depleted by $100 million. Reversions are not scheduled for 2011 (though they may be used). Instead, the state will draw its balances down by more than $300 million. Balances remain in the 10% to 12% "prudent range" in 2010, but dip below that range in 2011.

Beyond the New Biennium

In 2012 Indiana will face a problem, as will all the states: no more federal stimulus money. The ARRA program is scheduled to end after 2011. That leaves a big hole in the Indiana's state budget.

The scenarios in Table 2 look ahead to the 2012-13 biennium—the biennium after this one—to try to measure the likely condition of the budget. The table shows an abbreviated version of the state budget in checking account form, for three scenarios. Scenario one has a "business as usual" increase in appropriations. That's a 3.6% overall increase per year, a rate based on the average over the past ten years. It also shows "normal" revenue growth, at 4% per year, again based on past averages.

The budget doesn't work. Without the stimulus money the budget runs deficits of almost $900 million per year. Balances run down to 1.3% of revenues in 2012, and turn negative after that. That's unconstitutional. With normal revenue growth, the state will not be able to increase appropriations at the usual rate in the 2012-13 biennium.

Scenario 2 shows how fast revenues must grow to support business as usual appropriations growth. The answer is 7.5% per year in 2012 and 2013. In this scenario the budget is in deficit in 2011, and balances drop to 4.5% of revenues. This is below the rule-of-thumb minimum of 5%, so for a time the state could face cash-flow difficulties. But the deficit turns to surplus in 2012, and balances begin to rebuild.

Two straight revenue increases of 7.5% are unlikely. The state's economy would have to boom, growing more rapidly than is likely for two years. A state tax hike could increase revenue that much. An income tax rate hike from 3.4% to 3.8%, or an increase in the sales tax to 7.5%, would be enough. The General Assembly showed no sign of supporting tax hikes during the 2009 budget session, though.

Another way to support business as usual spending increases would be an extension of the Federal government's stimulus program. There will be plenty of states with budget difficulties in 2012; we can expect an intensive lobbying effort for the stimulus aid to continue.

Suppose none of these things happen, and revenues grow a more normal 4%. Scenario 3 shows that state budget appropriations would have to be flat-lined to balance the budget with normal revenue growth. There is still a deficit in 2012, and balances drop to 5.1% of revenues, but there is a surplus in 2013. Total appropriations do not change. However, Medicaid entitlements will increase if health care costs keep rising. This implies decreases in other spending categories, in particular K-12 education, where most of the money goes.

Another Tough Budget Session in 2011

Four percent a year is a more likely pace for revenue growth. That means a typical economic expansion, with no tax increases, and no more stimulus money. If that's what happens in 2012-13, the budget would have to be flat-lined to maintain positive balances. That means no spending increases, again.

And that means that the General Assembly will again divide a fixed amount of revenue among many competing interests. One added dollar for one function means a dollar less for another. Decisions like that are hard. We can expect another tough budget-writing year for the legislature in 2011.

Choices for Your Farm Operating Loss

George F. Patrick, Professor and Extension Coordinator

Midwestern producers, especially livestock producers, may find that their projected farm expenses exceed anticipated farm income for the current tax year. These farm losses are likely to cause cash flow difficulties. However, for some producers, farm losses may generate cash inflows in the form of tax refunds. Tax law allows choices with respect to farm losses. Losses in one tax year may be carried back to obtain refunds of taxes previously paid, or losses may be carried forward to offset tax liabilities in future years. Many farmers had high incomes in 2007 and 2008, and carrying back a 2009 loss is likely to generate an income tax refund. If carrying a 2009 loss back has little or no tax benefit, a producer can elect to carry the loss forward. Therefore, producers with farm losses should analyze their carryback and carryforward alternatives and not just file their current year's tax return.

The farm loss reported on Schedule F (Form 1040) is generally not the same as a net operating loss (NOL) for income tax purposes. The NOL concept is simple, but computation of the NOL deduction and NOL carryback can be quite complex. This complexity arises because various tax benefits must be removed by modifying the deductions of the loss year and modifying the income in the carryback year or years. Similar modifications are made if the loss is carried forward. Because of these modifications, the tax benefits of the loss may be reduced significantly. Before briefly discussing these modifications, this publication addresses some possible loss situations and general strategies for producers to avoid an NOL if possible.

Loss Situations and General Strategies

When farm expenses, including depreciation, exceed farm income on Schedule F, a farm loss exists. For sole proprietorships, partnerships, S corporations and limited liability companies taxed like partnerships, this farm loss flows through to the individual owners. (For regular or C corporations, a loss remains at the corporate level and is not discussed here. Perhaps an S election is warranted if years of losses are anticipated.) For the individual owner, these farm losses can create four different situations.

First, if the farm family has other income (such as gains from the sale of cull breeding stock, other business assets, nonbusiness assets, or an off-farm job) which is equal to or greater than the current year's Schedule F farm loss, then the farm loss is allowed in full and there is no NOL.

Second, farmers may be able to make adjustments in farm receipts and expenses to avoid an NOL when other income looks insufficient to offset the farm loss. Accelerating sales of grain, livestock and other commodities into the current tax year may help cash basis farmers avoid the NOL. Farmers who purchased depreciable assets in the current year have some flexibility with respect to depreciation. They may be able to avoid or reduce the size of this year's farm loss by electing to use straight-line depreciation methods and alternative longer useful lives for these assets. Also, major repairs done during the year could be capitalized rather than deducted as current expenses. Payment of some expenses could be delayed until the next tax year. The tax deductions associated with these adjustments would be recovered in future years.

Third, if the farm loss is greater than other income, the negative taxable income in this loss year must be recomputed to remove some tax benefits. For example, personal and dependent deductions, nonbusiness deductions in excess of nonbusiness income, capital losses in excess of capital gains and the domestic production activity deduction are added back. If the recomputed taxable income is not negative, there is no NOL for the year and nothing to be carried back or forward to other tax years.

Fourth, if the recomputed taxable income is negative, there is an NOL which can be carried to another tax year. Farmers may carry the NOL back two years, elect to carry a farm NOL back five years, or elect to carry the NOL forward up to 20 years. Because of high incomes in 2007 and 2008, many farmers will use the two-year carryback. Recent legislation allows 3 and 4 year carryback of losses. If the carryback period is used, the NOL may create a refund of part or all of the income taxes paid

by offsetting taxable income in the carryback year. If carrying back the NOL will not result in a tax refund, or only a small refund, an election to use only the 20 year carryforward period can be made and the carryforward will be available to reduce taxes in future years. In all of these cases, the NOL reduces taxable income but not earnings for the self-employment tax. The best choice with respect to the carryback vs. carryforward decision is the one that provides the highest net present value of expected tax savings for a family's specific situation.

Calculating and Distributing the NOL

To determine the NOL deduction and the portion of it which can be deducted in another year, a number of adjustments are necessary. Form 1045, Application for Tentative Refund, is used for calculating the NOL and reporting the adjustments. The five-year farm NOL carryback requires two Form 1045s to show the effects. Basically business income, including nonfarm wages and gains on disposition of business assets, minus business losses, including losses on disposition of business assets is adjusted in two ways. First, nonbusiness deductions (i.e., standard or itemized deductions) are deductible for computing an NOL only to the extent of nonbusiness income (i.e., interest, dividends, pensions, capital gains from nonbusiness investments, etc.). Second, capital losses are deductible for computing the NOL only to the extent of capital gains. After making these adjustments on Schedule A of Form 1045, the NOL which can be carried to other tax years has been determined.

If the two-year carryback is used, the current year NOL available for carryback must first offset income of two years ago. If the 3-4 or five-year carryback is elected, the current NOL would offset income from that prior year. The income of that year must also be modified to determine the amount of the NOL that is used or "absorbed" using Schedule B of Form 1045. Personal exemptions are not allowed as deductions in computing taxable income. The capital loss deduction is limited to the amount of capital gain included in income. Deductions based on or limited by a percentage of adjusted gross income (e.g., medical expenses and miscellaneous itemized deductions) must be recomputed. If the NOL is not fully absorbed by the modified taxable income of the first carryback year, then the amount which was not absorbed can be carried forward to the next eligible year (last year for the two-year carryback and four years ago for the five-year carryback). Similar modifications of the income for that year are also necessary to determine the amount of the NOL to be absorbed in that year. Any remaining NOL would be carried to the next tax year.

If an individual wishes to forgo the carryback and carry the current year's NOL forward, the election must be made on a timely filed tax return. Generally, the election to forgo the carryback period would be made in situations in which a carryback of the loss would result in little or no tax refund. In future years, the income adjustments discussed above will be needed to determine the amount of the NOL absorbed each year. If the election to forgo the carryback is not made on the current year's return, then individual must carry the NOL back two years before any remaining NOL may be carried forward. Tax benefits will be wasted if the carryback does not result in an income tax refund.

A current year NOL can interact with a farm income averaging election (Schedule J, Form 1040) from a prior year. Determination of the NOL is unaffected, and the full amount of the NOL is deducted to determine the income of a base year for income averaging. If a base year's income is reduced below zero, any NOL contributing to that negative income is required to be added back to compute to base year taxable income if the NOL may provide a tax benefit in another tax year. The Schedule J Instructions have a worksheet to perform the necessary add back calculations.

The carryback and carryforward provisions of the NOL can also be affected by other tax law provisions. A shift between joint and separate returns, divorce, marriage, or other changes in filing status can involve additional complications. In general, an individual's NOL is only allowed to offset that individual's income.

Summary

Taxpayers will generally seek to avoid an NOL, when possible, because of the loss of tax benefits in the recalculation of income. Year-end tax planning can identify potential NOL situations and possible adjustments to avoid the NOL. When an NOL does occur, a producer has choices as to how to use the NOL and will generally seek the largest tax-savings possible. The best use of an NOL will depend on an individual's circumstances and may require

considerable analysis of the alternatives. The calculations associated with computing an NOL and the amount absorbed in a carryforward/carryback year can be complex and time consuming. Producers should make decisions about the use of an NOL before they file their current year's tax returns. Competent tax advice, analysis, and planning is essential to make the most of an operating loss.

References

Harris, Philip E., Linda E. Curry and Nina S. Collum (editors) *2009 National Income Tax Workbook*, Land Grant University Tax Education Foundation, Inc., P.O. Box 835, Brownsville, Or 97327.

Internal Revenue Service, *Form 1040, Schedule J (Income Averaging for Farmers and Fishermen)* http://www.irs.gov/pub/irs-pdf/f1040sj.pdf and *Form 1040, Schedule J Instructions* http://www.irs.gov/pub/irs-pdf/i1040sj.pdf.

Internal Revenue Service, *Form 1045, Application for a Tentative Refund*, http://www.irs.gov/pub/irs-pdf/f1045.pdf and *Form 1045 Instructions*, http://www.irs.gov/pub/irs-pdf/i1045.pdf

Internal Revenue Service, *Net Operating Losses*, Publication 536, http://www.irs.gov/publications/p536/ar02.html

Purdue Crop Budget Update

*Alan Miller, Farm Business Management Specialist**

A rollercoaster ride for corn and bean prices is making estimating 2010 crop profit potential in Indiana challenging. When Purdue Ag Economists published an initial forecast for the 2010 crop year, corn and bean prices were down and profitability had gone the way of crop prices. As of the close of trading at the CME Group on November 19, 2009, fall 2010 prices for corn, and soybeans were up $.79 and $1.39 per bushel, respectively, from the crop prices used in our forecast back on September 9. Wheat prices for next summer are up too. Fortunately, input prices have been far less volatile this fall, so the cost estimates in the September 2009 forecast for the 2010 crop year are still reasonable. Table 1 summarizes the revised estimates of contribution margins for crops produced on average quality land.

Even though soybean prices are up more, the contribution margin (crop returns in excess of variable crop production costs) is up the most for corn. In early September the forecast contribution margin for rotation soybeans on average productivity farmland was $44 per acre higher than for rotation corn. The marketplace was probably trying to send a strong signal to South American soybean growers. Now the forecast indicates the contribution margin from rotation corn is $13 per acre higher than soybeans. For highly productive farm ground the contribution margin for corn now looks to be $42 per acre higher for rotation corn than rotation soybeans. For low productive ground the contribution margin only favors corn by $2 per acre.

Farmers and landowners are also reviewing rental arrangements at this time of year. Purdue's September forecast of cost and returns suggested cash rents in Indiana might be under pressure to fall in 2010 in response to very tight profit margins. The current estimates suggest that profit margins have improved enough that cash rents may no longer be under pressure to decline. For more information on cropland leasing see leasing resources online at: http://www.agecon.purdue.edu/extension/pubs/farmland_values_resources.asp

Table 1. Estimated Contribution Margins for 2010 Indiana Corn, Soybeans, and Wheat on Average Productivity Land.[1]

	Continuous Corn	Rotation Corn	Rotation Soybeans	Wheat	Double Crop Soybeans
Expected yield per acre	149 bu.	159 bu.	49 bu.	70 bu.	29 bu.
Expected price per bushel on November 19, 2009[2]	$4.09	$4.09	$9.79	$5.10	$9.79
Contribution margin per acre estimated on November 19, 2009	$246	$299	$286	$205	$122
Expected price per bushel on September 9, 2009[2]	$3.30	$3.30	$8.40	$4.20	$8.40
Contribution margin per acre estimated on September 9, 2009	$129	$174	$218	$142	$82

1 *The source of the September 2009 costs, yields, and contribution margin estimates in Purdue Extension Publication ID-166-W. http://www.agecon.purdue.edu/extension/pubs/id166_2010*

2 *Harvest corn price is December 2010 CME Group futures price less $.30 basis. Harvest soybean price is November 2010 CME Group futures price less $.45 basis. Harvest wheat price is July 2010 CME Group futures price less $1.00 basis.*

** Mr. Miller performs many roles in farm management education.*

The return to land from crop farming, which is left after deducting variable crop production expenses and nonland overhead costs from crop revenues, is one indicator of what cash rent a farm tenant might be able to afford to pay for cropland in 2010. On September 9, 2009, the return to land from growing corn and soybeans in rotation was forecast at $35, $106, and $190 per acre for low, average, and high productivity farmland, respectively. As of November 19, 2009, the forecast returns to land had increased to $112, $203, and $306 per acre, respectively for low, average, and high productivity land. Table 2 compares the returns to land forecast on September 9, 2009 and November 19, 2009. The $203 per acre return to land on average ground is $36 per acre higher than the average statewide cash rent in 2009 reported in the Purdue Ag Economics report in August 2009—online at: http://www.agecon.purdue.edu/extension/pubs/paer/

Ups and downs in crop prices go right to contribution margins, tenant's profit margins, and return to land. The rollercoaster ride for prices and for profitability measures is unlikely to continue. Updating your estimates of profitability for 2010 will continue to be a necessity at least until you lock in your prices for the 2010 crop year.

Table 2. Estimated Returns to Land for 2010 Indiana Corn-Soybean Rotation on Low, Average, and High Productivity Farmland.[1]

	Low Productivity Soil	Average Productivity Soil	High Productivity Soil
Average contribution margin per acre[2]	$218	$313	$418
Overhead costs excluding land costs per acre	$107	$111	$113
Return to land per acre on November 19, 2009	$112	$203	$306
Return to land per acre on September 9, 2009	$35	$106	$190
2009 cash rent per acre[3]	$131	$167	$208

1 Nonland overhead costs estimated for 3000 acre corn-bean rotation.
2 Including direct government payments.
3 Reported in ID-166-Indiana Farmland Values & Cash Rents: Relative Calm in a Turbulent Economy, Purdue Agricultural Economics Report, August 2009. Craig L. Dobbins and Kim Cook. http://www.agecon.purdue.edu/extension/pubs/paer/2009/august/dobbins.asp

Estate and Family Business Transfer Planning 2010 Programs

- January 14, 2010; 8:45 a.m. – 3:15 p.m., EST, Gasthof Restaurant and Bakery, CR 650 E 1 Mile North of U.S. 50 Montgomery, IN
- January 15, 2010; 8:45 a.m. – 3:15 p.m., EST, Sullivan County, 4-H Fairgrounds, 1301 E County Road 75 N, Sullivan, IN
- February 9, 2010; 8:45 a.m. – 3:15 p.m., EST, Venture Out Business Center, 975 Industrial Drive, Madison, IN
- February 9 & 10, 2010; 6:55 p.m. – 9:40 p.m., EST, Dearborn County Office, City Hall, 229 Main St., Aurora, IN
- February 10, 2010; 8:30 a.m. – 3:30 p.m. EST, 401 North Central Ave, Connersville, IN
- February 12, 2010; 8:30 a.m. – 3:30 p.m. EST, 14 Clubhouse Drive, Covington, IN

The presenter is Gerry Harrison, Extension Economist and member of the Indiana Bar. Harrison is a professor, Dept. of Agricultural Economics, Purdue University. Gerry has presented programs on estate and family business transfer planning for 36 years. Besides research, teaching and writing for Purdue Extension, he has taught three courses at Purdue: Estate Transfer Planning, Federal Income Tax and Agricultural Law. You may contact Gerry with a toll free call: 1-888-398-4636; and ask for Ext. 44216 or dial directly 765-494-4216; E-mail: harrisog@purdue.edu

These seminars are sponsored by Purdue Extension and the Department of Agricultural Economics, Purdue University. Topics discussed are intended for individuals, their spouses, adult children and especially those with interests in family-owned businesses. Professionals who assist others with their estate and financial planning needs are encouraged to register. Five hours of continuing education credit is available for Indiana professionals including: accountants (CPE), lawyers (CLE) and insurance producers (CE). *Preregistration is required and is handled by the Purdue Extension Offices in the respective host counties.*

COLLEGE OF AGRICULTURE *Department of Agricultural Economics* PURDUE UNIVERSITY

30th Annual Farming Together Workshop at Purdue University

As you look towards the future of your farming operation, there are many issues of strategic importance to consider. One such issue is the development of a son, daughter, or partner(s) to be the future manager(s) of your business. Another is developing a plan for transferring ownership interests in the business to the new partners. Another is developing contingency plans for events that could disrupt the succession plans of the farm business. These three issues, in fact, are typically three core elements addressed by an effective management succession plan.

We recently asked a group of producers attending our Top Farmer Workshop whether their family is prepared for management succession if it were to happen today. Only 38 percent of our respondents said yes. Clearly this appears to be a strategic concern that needs additional attention on many farms. To help farmers start the process of developing a management succession plan for their businesses, the Department of Agricultural Economics at Purdue University will host its annual Farming Together Workshop, on the West Lafayette campus on January 29-30.

Preregistration is required and the registration fee for registrations received on or before January 15, 2010, is $120 per farm. A brochure containing more information about the Farming Together Workshop including a registration form is available on the internet at: http://www.agecon.purdue.edu/extension/programs/FT_files/Farming_Together_Brochure_2010.pdf Specific questions about the workshop should be addressed to Alan Miller at millerwa@purdue.edu or 765-494-4203.

Contributors to this issue from the Department of Agricultural Economics:

Lawrence DeBoer
Professor

W. Alan Miller
Farm Business Management Specialist

George Patrick
Professor and Extension Economist

PAER Production Staff

Cathy Malady
Layout and Design

Gerald A. Harrison
Editor