STATEMENT OF
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For the Hearing
HOW TAX REFORM WILL HELP AMERICA'S SMALL BUSINESS GROW AND CREATE JOBS

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Committee on Ways and Means
Subcommittee on Tax Policy

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Chairman Roskam, Ranking Member Doggett and members of the Subcommittee for Tax Policy, thank you for scheduling this hearing about how tax reform will help America's small businesses to grow and create jobs. I appreciate this opportunity to speak about the need for tax reform and to highlight the tax code provisions important to the long-term financial success of farm and ranch businesses.

My name is Scott VanderWal and I along with my father, uncle and son operate VanderWal Farms in Volga, South Dakota. Our family farming business was started in the 1940s by my grandfather on about 300 acres of land. Today we farm 1300 acres of corn and soybeans, operate a feedlot where cattle are prepared for market and harvest crops for neighboring farmers. While farming is my occupation, I also serve as Vice President of the American Farm Bureau Federation and as President of the South Dakota Farm Bureau Federation.

Most farms in the U.S. are family owned and operated. According to USDA, family farms comprise 99 percent of all U.S. farms and account for 89 percent of production. While our farm is typical for South Dakota, agriculture operations across America vary greatly in the commodities they produce, their size, their reliance on labor, and by the length of their production season. Collectively agriculture, food, and related industries contributed $992 billion to U.S. gross domestic product (GDP) in 2015, a 5.5-percent share. On a value added basis America's farms contributed $136.7 billion of this sum, about 1 percent of GDP. Agriculture and its related industries provide about 11 percent of U.S. employment. Food manufacturing accounts for 14 percent of all U.S. manufacturing employees. U.S. agriculture accounts for 9 percent of total U.S. exports and maintains a positive trade balance year on year.

Even with agriculture's great diversity, all family-owned farms and ranches share several things, including that they operate in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncontrollable weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. In fact, prices of feed grains and feeder cattle, which are central to my business, have fluctuated 53 percent and 85 percent, respectively, over the last decade. Farmers and ranchers need a permanent tax code that recognizes the financial challenges they face.

Another thing that my fellow farmers and ranchers share is that we operate under tight profit margins, often for rates of return that are modest compared to other businesses. This is especially true today as the U.S. farm economy is in the midst of a serious financial downturn. Net farm income has fallen by nearly half, just since 2011. What is needed are tax policies that support high-risk, high-input, capital-intensive businesses like farms and ranches.

Tax reform must be comprehensive and treat farm and ranch businesses that operate as individuals, pass-through businesses and corporations fairly. While our farm functions as a family-owned C-corporation, more than 95 percent of farms and ranches are taxed under IRS provisions affecting individual taxpayers. This is true across all farm sizes – from those earning less than $1,000 in revenues per year, all the way to farms earning more than $5 million. Tax reform that fails to treat sole proprietors, partnerships, S-corporations and C-corporations fairly will not help, and could even hurt, the bulk of agricultural producers who operate outside of the corporate tax code.

Farming and ranching is a cyclical business where a period of prosperity can be followed by one or more years of low prices, poor yields or even a weather disaster. Using our farm as an example, over the last 10 years we have been paid as much as $7.60 a bushel for corn and as little as $2.80. Our yields have ranged from 210 bushels an acre to 160. Tax code provisions such as expensing, bonus depreciation and cash accounting, allow farmers and ranchers to match income with expenses helping them to survive difficult financial times. Provisions that allow agricultural producers to even out their taxable income- for example, like kind exchanges, income averaging and installment sales- allow farmers and ranchers to pay taxes at an effective tax rate equivalent to a business with the same aggregate, but steady revenue stream.

<u>Lower effective tax rates will benefit farm and ranch businesses.</u>

Reducing effective tax rates is the most important thing that tax reform can do to boost farm and ranch businesses. This is especially true during the current downturn in the agriculture economy. Profit margins on our farm have been extremely tight since 2013 forcing us to operate at or below our cost of production. Every dollar that we pay in taxes is a dollar that could be reinvested back into the farm to replace and upgrade our equipment, improve our feedlot, expand our crop production or hire farm workers. Any investment made will not only be good for our farm business but will lift my community and contribute to a robust agricultural economy.

While lower tax rates are important, the critical measure of any tax reform plan for farmers and ranchers will be the effective tax rate paid by farm and ranch businesses. Tax reform that lowers rates by expanding the base should not increase the overall tax burden of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions, credits and exemptions for all rate brackets could result in a tax increase for agriculture.

Accelerated cost recovery helps farmers and ranchers to be productive and efficient.

Immediate expensing reduces taxes in the purchase year, providing readily available funds for upgrading equipment, to replace livestock, to buy production supplies for the next season and for farmers to expand their businesses. Because farms, including ours, have high production input costs, it is especially helpful to be able to write-off the cost of equipment and production supplies rather than have to depreciate them over time. With the price of a combine topping well over half a million dollars, it is easy to appreciate how much immediate expensing helps our farm business to cash flow. Expanding expensing opportunities will help farm and ranch businesses that have high input costs and sometimes bump up against current expensing limits. Being able to carry deductions forward indefinitely and indexing them for inflation is important to cyclical businesses like farming and ranching with tight profit margins.

Deducting interest expenses is important for financing of farm and ranch investment.

Debt service is an ongoing and significant cost of doing business for farmers and ranchers who, like my family, depend on borrowed money to buy land and buildings, vehicles and equipment, and production inputs. We rely on debt financing because outside investors often aren't interested in low-profit high-risk businesses like agriculture and because family-owned businesses like farming and ranching often aren't interested in having outside investors as business partners.

Interest paid on loans should continue to be deductible because interest is a legitimate business expense. According to the 2012 Census of Agriculture, farmers in my home state of South Dakota, spent more than $209 million on interest expense and averaged more than $21,000 per farm. If my family can't deduct interest it will make it more expensive for our farm business to borrow money or could restrict the amount of money we can borrow. If our farm debt load becomes too great, the long-term viability of our business operation will be called into question.

During the difficult economic times agriculture now faces, the ability to borrow money is more critical than ever. I also worry about beginning farmers like my son who rely even more heavily on debt financing than I do to buy the land, equipment and supplies they need to get started. With the average age of farmers and ranchers at over 58 and rising, availability of capital for new and beginning farmers is more important than ever for the long-term growth of our industry.

Repealing estate taxes will help farm and ranch business to transfer to the next generation of agricultural producers.

My family is actively involved in succession planning, and even though our farm business is currently valued under the estate tax exemption, we often discuss the impact of estate taxes. I know from talking to other farmers and ranchers from across the country just how worried they are that their business will die with them because of estate taxes. Some farmers worry about estate taxes because of escalated land values that in my area can be as high as $8,000 an acre for good farmland. Some worry because their businesses have grown to take in sons and daughters or to achieve economies of scale. They spend money on life insurance and estate planning to try to protect their farms and ranches even though these funds would be better spent to upgrade buildings and equipment, upgrade livestock or expand their businesses.

<u>Maintaining stepped-up basis is important to farmers and ranchers.</u>

Repealing the estate tax is important but so is continuation of unlimited stepped-up basis. Some of the land that we farm was purchased for $200 to $400 an acre and is now worth as much as $9,000 an acre. Since our farm is currently under the estate tax exemption, the repeal of stepped up basis would create a new and substantial capital gains tax for family-owned farm and ranch businesses, including ours.

<u>Reducing taxes on capital gains will help farms and ranches to grow and upgrade their businesses.</u>

Capital gains taxes are owed when farm or ranch land, buildings, breeding livestock and timber are sold. While long-term capital gains are taxed at a lower rate than ordinary income to encourage investment and in recognition that long-term investments involve risk, the tax can still discourage property transfers or alternatively lead to a higher asking price. As my family plans for the transition of our farm from one generation to the next, we struggle with the impact that capital gains taxes are having on the transfer of business property. In addition, questions about the deductibility of interest expenses are factoring into our planning. While the impact is significant for established farms and ranches like ours, it is magnified for beginning farmers and ranchers who must purchase and finance the land and equipment that they need to get started in the business.

<u>Cash accounting helps farm and ranch businesses to match income with expenses to improve cash flow.</u>

Cash accounting is the preferred method of accounting for farmers and ranchers because it is simple, it allows them to match income with expenses and it aids in tax planning. Our farm business uses cash accounting. This allows us to improve cash flow by recognizing income when it is received and recording expenses when they are paid. It gives us the flexibility we need to plan for major business investments and in many cases provides guaranteed availability of some agricultural inputs. It also allows us to control the timing of expenses to balance against revenue and target an optimum level of income for tax purposes.

Loss of cash accounting would create a situation where we might have to pay taxes on income before receiving payment for sold commodities. Not only would this create cash flow problems, but it also could necessitate a loan to cover ongoing expenses until payment is received. The use of cash accounting helps to mitigate this challenge by allowing us to make tax payments after we are paid for our commodities.

Like-kind exchanges help agricultural producers to operate successful businesses.

Section 1031 like-kind exchanges help farmers and ranchers operate more profitable businesses by allowing them to defer taxes when they sell business assets and replace them with better land or buildings, more efficient vehicles and equipment and upgraded livestock. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to improve their farm or ranch businesses or, worse yet, delay improvements needed to maintain the financial viability of their farm or ranch. I know farmers and ranchers who were able to continue farming and ranching when they used a like-kind exchange to sell farmland in the path of urban sprawl and move to a different location, sometimes with an expanded operation.

In Summary: Congress, and the Committee on Ways and Means in particular is to be commended for moving forward with comprehensive tax reform designed to spur growth of our nation's economy. Many of the provisions of the committee's tax reform blueprint will be beneficial to farmers, including reduced income tax rates, reduced capital gains taxes, immediate expensing for all business inputs except land and the elimination of the estate tax. The proposed loss of the deduction for business interest expense, however, is a cause for concern. The blueprint can be improved by guaranteeing the continuation of stepped-up basis, preserving cash accounting and maintaining like-kind exchanges. Thank you again for the opportunity to visit with you today about the importance of tax reform and how it will help America's small businesses, including farms and ranches, to grow and create jobs.