FARM Assistance Focus

Texas Cooperative
EXTENSION
The Texas A&M University System

Impacts of Proposed Tax Provisions (Senate Versions of House Bills 2 and 3, 79th Texas Legislature)

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FARM Assistance is a financial planning model used to help producers evaluate alternative management strategies.

In an ongoing effort to reconcile the funding of Texas' public school system as well as to provide meaningful property tax reductions, the 79th Texas Legislature has proposed two bills (HB 2 & 3) that seek to achieve both these objectives. The development of this legislation has raised the question of the potential impacts any shift in the tax burden may have on agricultural producers. This paper estimates the impact of the Senate's version of proposed tax provisions on Texas farmers and ranchers. Specifically, the analysis focuses on the farm and ranch participants in Texas Cooperative Extension's Financial and Risk Management (FARM) Assistance program.

FARM Assistance is a financial planning model used to help producers evaluate alternative management strategies. Data collected and used in individual analyses has led to an extensive database of individual producer data reflecting the program's clientele in Texas. From this database, 185 operations that recently completed the FARM Assistance program were selected for analysis. Impacts are also estimated for subgroups of producers based on type of production.

The producer types consist of crop farms, livestock ranches, and diversified operations defined as follows:

- **Crop Farm:** An operation whose crop enterprise(s) accounts for 75% or more of total receipts
- **Livestock Ranch:** An operation whose livestock enterprise(s) accounts for 75% or more of total receipts
- **Diversified:** An operation that does not meet the criteria for classification as a Crop Farm or Livestock Ranch

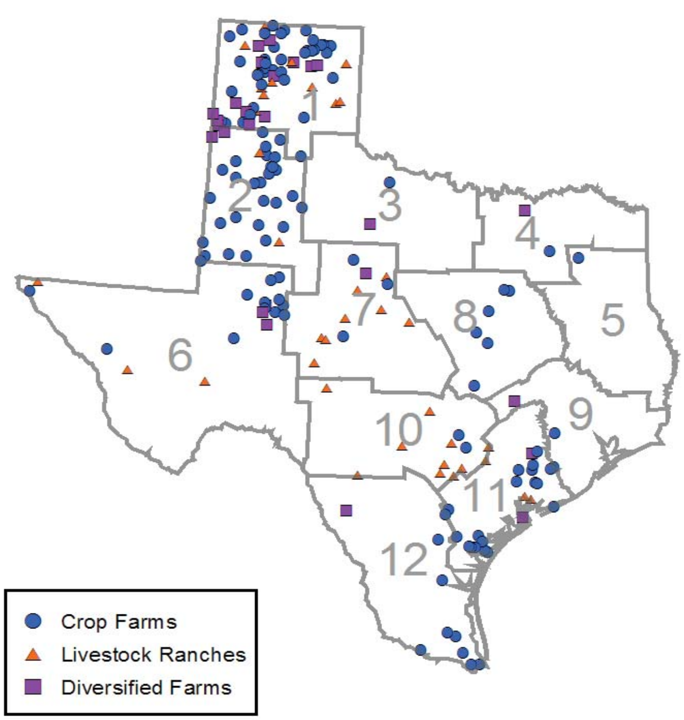
Average impacts are also reported by crop enterprise. The 149 crop and diversified operations were further categorized as corn, cotton, grain sorghum, and wheat producers. An operation is classified as a corn producer if corn makes up at least 25% of the planted acres, and similarly for the three other commodities. Several farms fall into more than one category.

Tax Provisions & Assumptions

The Senate Bills propose a reduction of property taxes that would be offset by a newly structured business tax. The proposal for a business tax includes a broader enforcement of the existing franchise tax, an alternative tax based on payroll, and a minimum tax based on gross receipts.

Property Taxes Changes

FARM Assistance Participants by Type of Farm



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Property tax savings result from provisions reducing the maximum school tax rate from $1.50 to $1.10 per one hundred dollar valuation. Actual savings could be less than $0.40 for districts not currently at the maximum $1.50 tax rate. This study assumes a $0.35 savings on a total property tax bill of $2.25 per one hundred dollar valuation (including county, city, school M&O, and school I&S). Savings estimates do not include the potential additional taxes allowed by local enhancement provisions. The analysis does not include any change in rental arrangements, lease rates, or land values.

Franchise Tax

The franchise tax is calculated as the higher of: 1) 2.5% tax on a taxable base defined as net farm income plus payroll compensation minus an allowable deduction equal to the lesser of 50% of compensation or $30,000 per employee, and 2) 0.25% tax on taxable capital (net worth)

Payroll Tax

A 1.75% payroll tax was assumed for all part-time and full-time labor. A $1500 per employee cap on the payroll tax was not effective for any of the 185 operations.

Business Tax Choices

Businesses are assumed to elect the smaller of the Franchise and Payroll taxes. The payroll tax would be smaller for almost 97% of the FARM Assistance participants.

Gross Receipts Tax

Once a choice is made between the franchise and payroll tax calculations, Senate bill provisions also require that the final business tax meet a minimum threshold. A minimum business tax equal to 0.25% of gross receipts is assumed. Production agriculture, being a high volume -- low margin business, would be significantly impacted by a tax calculated on gross receipts. The minimum gross receipts tax would be effective for 170 of the 185 operations in the study group.

Exemptions

Sole proprietors are exempt from the proposed business tax. While most FARM Assistance participants are sole proprietors, some are corporations and partnerships, and many have the flexibility to change their entity designation if necessary. The data is used to illustrate the tax implications under two assumed scenarios. Estimates of the proposed tax implications are calculated assuming 1) that all farms and ranches are subject to the business tax, and 2) that all farms and ranches are sole proprietors, exempt from the business tax.

Sales Tax

Sales tax increases are also proposed, but farms and ranches are assumed to remain exempt from sales taxes. While a higher sales tax would increase producers' family living expenses, the impact should be minimal and no estimates of increased family living expenses are included in this analysis.

Impacts

Net Cash Farm Income is provided in Table 1 to illustrate the relative impact of the tax provisions. Net cash farm income does not include depreciation or cash obligations such as principal payments on term debts, federal income & social security taxes, and family living expenses. Impacts for individual operations vary beyond the averages reported in Table 1, but on average the net tax impact would be a cost to producers of $889 each year, assuming all producers are subject to the business tax. Livestock ranches and diversified operation would incur the greatest increase in their tax bills with an anticipated increase of $1,100 and $1,094 respectively. Crop farms would also incur additional tax, $778 on average, approximately 29% less than either livestock ranches or diversified operations.

For individual operations, the net tax impacts range from a net increase of $18,500 to net savings of $2,500. Within this group, diversified operations, having the highest receipts, would be most impacted by the gross receipts tax, which, on average, would result in an additional $2,197 of tax burden. Because diversified operations tend to own a larger portion of their productive land than crop farms or livestock ranches, they will tend to see the highest savings from a property tax reduction. These savings are estimated to average $1,211, which is more than double the savings estimated for the other two producer types. Crop farms and livestock ranches ex-

Assuming all 185 operations were exempt from the business tax the group could expect an average net tax savings of $678 as a result of the proposed tax legislation.

hibit similar impacts from the gross receipts tax (around $1,400), and similar property tax savings of approximately $590 on average.

However, the majority of the producers, due to their status as sole proprietors, would be exempted from the business tax. Assuming all 185 operations were exempt from the business tax the group could expect an average net tax savings of $678 as a result of the proposed tax legislation.

The impacts of the proposed tax provisions on crop farms and diversified operations can be further broken down by the primary commodity grown on each farm. Table 1 presents these impacts for four major Texas crop commodities. Corn and cotton producing operations are estimated to see the greatest increase in their tax burden, assuming all are subject to the tax, with an additional $1,046 and $951 of tax resulting from the proposed business tax. This is significantly more than the $551 and $687 increases estimated for sorghum and wheat operations, which is due to the lower value of these crops relative to corn and cotton. However, if these farms are excluded from the business tax, wheat operations would see the greatest tax savings ($717) among the four commodities. Tax exempt corn, cotton, and sorghum operations are estimated to have a reduction in their tax burden by $597, $515, and $424 respectively.

Table 1. Average Annual Impacts of Proposed Tax Provisions (Senate version of House Bills 2 and 3, 79th Legislature)

	All Farms & Ranches	Crop Farms	Livestock Ranches	Diversified Operations	Corn	Cotton	Sorghum	Wheat
Number of Operations	185	121	37	27	34	65	32	53
Average Annual Total Receipts	$606,257	$537,169	$633,168	$878,994	$655,366	$586,642	$389,895	$560,597
Average Annual Net Farm Income	$83,841	$105,726	$21,242	$71,549	$117,232	$114,332	$55,417	$99,945
Proposed Business Tax								
Payroll Tax	$621	$560	$624	$886	$550	$581	$388	$401
Franchise Tax	$3,765	$3,712	$3,108	$4,902	$3,978	$3,844	$2,062	$3,732
Elect Payroll or Franchise	$601	$556	$539	$886	$550	$579	$375	$398
Number electing the payroll tax:	179							
Gross Receipts Tax (GRT)	$1,516	$1,343	$1,583	$2,197	$1,638	$1,467	$975	$1,401
Business Tax Paid	$1,566	$1,363	$1,692	$2,305	$1,643	$1,467	$975	$1,405
Number Paying Minimum GRT:	170							
Property Tax Savings	$678	$585	$592	$1,211	$597	$515	$424	$717
Average Net Impacts (assuming all operations are subject to business tax)								
Average Net Tax Increase	$889	$778	$1,100	$1,094	$1,046	$951	$551	$687
Number realizing a net tax increase	143	96	26	21	31	57	21	40
Number realizing a net tax savings	42	25	11	6	3	8	11	13
Average Net Impacts (assuming all operations are sole proprietors and exempt from the business tax)								
Net Tax Savings	$678	$585	$592	$1,211	$597	$515	$424	$717

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