The Honorable Pat Tiberi
Chair, Subcommittee on Select Revenue Measures
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

NATIONAL PORK PRODUCERS COUNCIL

The Honorable Richard E. Neal
Ranking Member, Subcommittee on Select Revenue Measures
House Ways and Means Committee

RE: Hearing on Ways and Means Small Business and Pass-Through Entity Tax Reform Discussion Draft

Dear Chairman Tiberi and Ranking Member Neal:

The National Pork Producers Council submits, for the hearing record dated May 15, 2013, the attached letter detailing U.S. pork producers concerns regarding impacts on the production of U.S. pork and pork products pursuant to the Ways and Means Small Business Discussion Draft released March 12, 2013.

Should you have any questions, please contact:

Ms. Audrey Adamson
Vice President, Public Policy
National Pork Producers Council
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Sincerely,

Randy Spronk
President
National Pork Producers Council

May 13, 2013

The Honorable Dave Camp
Chairman, House Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Sander Levin
Ranking Member, House Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Camp and Ranking Member Levin:

The National Pork Producers Council is an association representing a federation of 43 state producer organizations and the federal and global interests of 67,000 U.S. pork operations that annually generate approximately $15 billion in farm gate sales. The U.S. pork industry supports an estimated 550,000 domestic jobs and generates more than $97 billion annually in total U.S. economic activity.

We have several pork industry specific concerns with the Committee's Discussion Draft Provisions to Reform the Taxation of Small Businesses and Pass-through Entities, released March 12, 2013, particularly its unintended consequences.

The proposal contemplates restricting the use of cash basis accounting by even the smallest scale commercial pork producers. Under this method of accounting, cash revenues received in any year are attributed to total gross income for that tax year. Generally, expenses such as animal feed, animal health products, etc. are deducted in the tax year in which they are paid. U.S. pork producers/farmers are not covered by the requirement that taxpayers with over $5 million of annual gross receipts use accrual basis accounting. However, a family farm corporation is required to use accrual accounting if it has gross receipts of more than $25 million for any tax year since 1985. A family corporation is one where 50 percent or more of the corporate stock is held by one family (or in some cases, two or more families). In addition, a partnership that has a corporation as a partner is unable to utilize cash basis accounting.

The Committee Discussion Draft proposes eliminating the "special exceptions" for farming businesses, an action that would expose small- to medium-sized pork farmers to the general limitation on the use of cash method accounting for federal income tax purposes. Those limitations would force taxpayers with average gross receipts of $10 million or more for the three prior taxable years to use accrual basis accounting.

And reaching that $10 million threshold is quite common in the U.S. pork industry. An operation with 3,000 sows, for example, would surpass the threshold, or one with 1,500 sows and about 4,200 acres of corn would as well. Those farms would be considered "medium-sized" operations.

Today, many U.S. pork producers/farmers use the cash method of accounting because they find it easier to keep farm records and because it more accurately reflects the nature and volatility in income during a period of years. While this issue is not unfamiliar to small businesses, it is perhaps more significant in the agriculture industry and particularly in the livestock business because of the longer lead time in growing a live animal from birth to market and because of the many largely uncontrollable factors such as weather and volatility of commodity markets in general and livestock and feed stocks in particular. On-farm livestock income fluctuates greatly from year to year. Under the Discussion Draft proposal, producers/farmers would need to recognize income that might not ultimately materialize, the accrual basis of accounting accelerates the recognition of income on pigs that have yet to go to market.

Even with a 10-year phase-in, U.S. pork farms/entities that previously used the cash basis would confront a situation whereby the cost of inventory – pigs in progress and pigs that are not ready to go to market, meaning younger pigs – would in effect become immediately taxable. Most market hogs are harvested around six months of age and require approximately one year from conception to market. Farmers raising pigs would be required to recognize income on pigs that might not go to market until the following tax year and, since they are not paid until after the pigs are delivered to the packing house, those farmers would be recognizing income for tax purposes without actually receiving cash with which to pay the resulting tax. In addition, receivables from packing houses and other customers, prepaid expenses, as well as other inventory items (such as animal feed ingredients, farm supplies, et cetera), would be effectively taxed well before cash is received.

Requiring U.S. pork producers to use the accrual method of accounting would subject them to Section 263 inventory capitalization rules. Compliance with the hundreds of pages of regulations under Section 263 would create a massive burden for smaller U.S. pork producers from a professional accounting and administrative cost perspective. The computations required under Section 263 can be complex and open a "whole new world" to many smaller U.S. pork producers. This is not tax simplification but rather a proposal that would impose massive compliance costs that would threaten to put smaller U.S. pork producers out of business.

Additionally, the proposal violates the principal that a tax should not be imposed until cash is received with which the taxpayer is able to pay the tax. The cumulative net difference of taxable income, now taxable under this proposal, would require that most U.S. pork producers borrow money to pay related taxes. This will have an inordinate impact on smaller pork producers/farmers, many of whom may not be able to obtain financing to pay these new federal taxes.

Paying taxes on inventory "in progress" might actually result in a "double whammy" situation. If livestock markets deteriorated and costs on inputs such as animal feed rose precipitously – as has been the case over the past six years because of numerous factors, including commodity speculation and federal renewable fuels mandates – this situation could create a net loss in the subsequent tax year. In other words, federal taxes are paid on inventory "in progress" in one year, then losses (real cash losses) are incurred in the next, some of which might not be recoverable immediately via the federal tax rules and regulations at the applicable time.

Further, the effects of the proposed change will be compounded because many U.S. pork producers live in "high income tax" states such as Minnesota, the second-largest pork-producing state, and they would bear an additional state income tax burden.

Finally, we would offer several additional comments on specific sections of the proposal.

NPPC is concerned that there appears to be "discrimination" built into this proposal in terms of treatment of sole proprietorships versus any number of pass-through entities (partnerships and Sub Chapter S corporations). The proposal appears to violate the principal that tax liability should not differ between similarly situated sole proprietorships and any number of pass-through entities. If Subchapter S Corporation "farmers" are now going to be required to report taxable income using the accrual method, so must all farmers—regardless of the organizational structure of their business.

NPPC opposes the proposed reduction in the level of immediate expensing of capital additions. If implemented, it would reduce the long-term competitiveness of the U.S. pork industry. The proposed Section 179 provisions are yet another deterrent to successful U.S. pork farming and to investing in the future of U.S. pork production. The U.S. tax code should encourage the expensing of all on-farm capital additions. We would support and encourage 100% expensing of all capital additions for federal tax purposes. This is the only way that the U.S. pork industry will remain ahead of its global competitors in the production of pork and pork products. The tax code should encourage U.S. pork producers to invest in barns, automatic feeders, ventilation equipment and other technology to ensure the long-term future and global competitiveness of the U.S. pork industry.

In conclusion, we thank Chairman Camp and Ranking Member Levin for soliciting comments from stakeholders. We look forward to the opportunity for further dialogue on the impacts this proposal would have on the U.S. pork industry. Should you need additional information or wish to discuss further, please do not hesitate to call Audrey Adamson, Vice President, Public Policy, at (202) 347-3600, or alternatively she can be reached at adamsona@nppc.org.

Sincerely,

Randy Spronk

Randy Spronk
President
National Pork Producers Council

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