

Dear Reps. Gerlach and L. Sanchez,

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue neutral and fair to agricultural producers.

We commend the Ways and Means Committee on its methodical approach to tax reform by forming working groups to review current law and to compile feedback from stakeholders, academics, think tanks, practitioners, the general public and elected representatives. We offer the following comments on the domestic production activities deduction to you as the chair and co-chair of the manufacturing working group.

The domestic production activities deduction (Section 199) is designed to encourage domestic production and production-related activities. Domestic production activities include the lease, rental, license, sale, exchange or other disposition of tangible personal property that was manufactured, produced, grown, or extracted in whole or in significant part within the United States and is not limited to exported goods. The deduction is limited to the lesser of 9 percent of adjusted gross income or domestic production activities income or 50 percent of wages paid to produce such income.

As domestic producers of food, fiber and fuel, farmers and ranchers are correctly eligible for the domestic production activities deduction. However, restricting the deduction to 50 percent of wages paid limits applicability to farmers and ranchers who produce labor-intensive commodities such as fruits, vegetables and milk. It also rules out smaller agricultural operations that use only family labor to grow or produce agricultural products. In fact, America's farmers and ranchers produce more than \$400 billion worth of food, fiber and fuel annually with only 22 percent of operations employing farm workers.

Even with these limiting factors, IRS tax data shows approximately 7 percent of farm households directly benefit from the deduction. While the wages-paid limitation reduces the deduction for many smaller farms that hire little or no labor, farm sole proprietors deducted nearly \$1.25 billion in 2010. In addition, the average deduction for eligible farm households was \$8,926. (USDA Economic Research Service, Economic Information Bulletin 107, February 2013).

Reducing or eliminating the domestic activities deduction would result in a significant increase in taxable income for all farms that currently employ non-family labor. On the other hand, the benefit of the deduction would increase if agricultural producers were able to count wages paid as non-cash wages, such as crop share payments of commodities, and wages paid to their children working on their farms.

As a result of the deduction limitation of the lesser of 9 percent of adjusted gross income or domestic production activities income or 50 percent of wages paid to produce such income, many farmers cannot use the deduction on their own. However, the law allows farmer-owned cooperatives (Subchapter T) to calculate the deduction based on its wages, and then pass it through to its members on a patronage basis. This greatly enhances the benefit of the deduction for eligible farm and ranch businesses.

Non-corporate entities paying taxes in the individual income tax system as sole proprietors, partners and other pass-through entities are able to benefit from the domestic production deduction. Currently, an estimated 25 percent of Section 199 revenue losses are for claims made through the individual income tax system by pass-through entities, including S corporations and partnerships. (CRS: The Production Activities Deduction: Background and Analysis, February 27, 2012) As the vast majority of farm and ranch businesses are not incorporated and therefore pay taxes as individuals, these businesses would face higher effective tax rates if the Section 199 deduction was reduced as a trade off to lower corporate tax rates. Therefore, any tax reform measure that changes the deduction must provide commiserate tax relief to businesses that pay taxes as individuals.

Farm Bureau greatly appreciates your consideration of our views on the domestic production activities deduction. We would be glad to meet with you to provide additional information or to discuss our position in greater detail.

Sincerely,

A handwritten signature in black ink, appearing to read 'Bob Stallman', with a long horizontal flourish extending to the right.

Bob Stallman
President