Virginia Cooperative Extension

Farm Business Management Update
June – July 2005

To: Extension Unit Directors, Extension District Directors, Extension Program Directors, and Farm Management Agents, and ANR Specialists

Dear Co-Workers:

Farm Business Management Update is a joint effort of the Agricultural and Applied Economics faculty and the area farm management agents. Subject matter areas include timely information on farm management, marketing, tax management, finance, credit, labor, agricultural law, agri-business, estate planning, 4-H and economic education, natural resources, and CRD. Please use this information in your on-going Extension programs and circulate to all Extension staff. **Farm Business Management Update** is electronically accessible via the Virginia Cooperative Extension World Wide Web site (http://www.ext.vt.edu/). To see the articles listed in the reverse chronological order, select "News," then select "Farm Business Management Update" listed under the heading "Periodicals."

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Virginia Tech
VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY

Issued in furtherance of Cooperative Extension work, Virginia Polytechnic Institute and State University, Virginia State University, and the U.S. Department of Agriculture cooperating. Patricia Sobrero, Director, Virginia Cooperative Extension, Virginia Tech, Blacksburg; Lorenza W. Lyons, Administrator, 1890 Extension Program, Virginia State, Petersburg.

VIRGINIA STATE UNIVERSITY

The Management Calendar

By Gordon Groover, (xgrover@vt.edu), Extension Economist, Farm Management, Agricultural and Applied Economics, Virginia Tech

So far this spring folks in the New River Valley have experienced cooler temperatures and NOAA http://weather.gov/outlook_tab.php shows we are running about 5 inches low on rainfall. Yet we have seen almost 5 days of wet and overcast skies leading to poor field work conditions with little hay being made so far this year. Regardless of the weather, here are some management activities to consider putting on your management calendar during June and July.

- Half the business year will soon be behind you, so a 6-month financial record checkup is in order. Updating your records through the month of June allows you to quickly gauge financial progress by comparing the farm's actual expenses and income to your budgeted amounts. If you did not develop a budget, compare your mid-year expenses and income to half the items reported on your 2001 Schedule F. Flag any items that are different from budgeted amounts. These differences are not necessarily problems, just items that need to be examined and explained.

- Watch your line-of-credit and compare it to previous years, watching for large changes from your past experiences.

- Production records for livestock and crops should be updated for the first half of the year. Look for big changes from last year, and make sure to cross-reference these with production expenses.

- Update your marketing plan by collecting information on prices and world market situations. Be sure to check with your local Farm Service Agency for changes in government programs and signup deadlines. Review USDA and other crop and price forecasts. You can find the dates for USDA Agency Reports Calendar release with links to the appropriate agency web sites at http://www.usda.gov/news/releases/rptcal/calindex.htm

- Update estimates of harvest time and yields and develop new plans for possible delays or shortfalls of forages for late harvest.

- You can find up-to-date information on your county's Loan Deficiency Program (LDP) and Posted County Price (PCP) at the following Farm Service Agency web site http://www.fsa.usda.gov/dafp/psd/ldp/default.htm.

- Even with the time constraints of summer activities, try to plan and hold regular staff meetings with family members and employees to discuss work plans and set priorities for the next day/week. Consider brainstorming about alternative ways to deal with problems. Use some of the time to help discuss positive outcomes of previous plans and recognize individuals for being creative and doing a good job.

- Interested in share livestock arrangements? Look at William Edwards, extension economist, Iowa State, who has a news article on "Beef Cow Sharing Agreements." It can be found at http://www.extension.iastate.edu/agdm/articles/edwards/EdwMay05.htm.

- Perplexed by how to price valued added products? You might want to take a look at a news article by Nancy Giddens, Joe Parcell, and Melvin Brees, Department of Agricultural Economics, University of Missouri, titled "Selecting an Appropriate Pricing Strategy." The article can be found at http://www.extension.iastate.edu/agdm/wholefarm/html/c5-17.html.

- Checking your credit rating in July should become an annual event. Independence Day should remind you that you should be independent from identify theft and credit mistakes. All individuals and business owners should annually check their credit ratings. Access to free reports started on the West Cost and has been progressing eastward. Southern states (Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, Oklahoma, South Carolina, Tennessee, and Texas) gained access June 1st and by September 1, 2005, the rest of the states, D.C. and territories (Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia, Puerto Rico, and all U.S. territories) will be able to access free copies of their credit reports annually. By timing your requests, you can effectively check your credit three times a year. You'll just have to set up a calendar to keep track of which time of the year you should send out your request. Additional information on your rights to access your credit reports can be found at the Federal Trade Commission's web site at http://www.ftc.gov/bcp/conline/edcams/credit/ycr_free_reports.htm. The three main credit reporting agencies are:

    - Equifax Credit Information Services, Inc.
      P.O. Box 740241
      Atlanta, GA 30374
      Phone: (800) 685-1111
      Web page: http://www.equifax.com/
    - Experian
      475 Anton Blvd.
      Costa Mesa, CA 92626
      Phone: (888) 397-3742
      Web page: http://www.experian.com/
    - TransUnion
      P.O. Box 2000
      Chester, PA 19022
      Phone: (800) 888-4213
      Web page: http://www.transunion.com/

June-July marks the end of spring and the flurry of summer activities; enjoy!

2005 Northern District Farmland Leasing Survey[1]

By Keith Dickinson, (Keith.Dickinson@vt.edu), Extension Agent, Farm Business Management, Northern District

During the winter and late spring of 2005, the Virginia Cooperative Extension Farm Business Management Program surveyed farmers and farmland owners in 14 counties* (Albemarle, Caroline, Culpeper, Fluvanna, Greene, King George, Loudoun, Louisa, Madison, Nelson, Orange, Prince William, Rappahannock, and Spotsylvania) located in the Northern Extension District. A total of 139 usable surveys were returned, representing 12,792 leased acres across the region. The information obtained from these surveys is intended to be used as a teaching tool for local extension agents in assisting tenants and landlords in establishing leases for their farming operations. Landowners and farm operators can use the results as a starting point for the negotiations of leasing rates. The results should not be used as a guide for "setting" the leasing rate for a given location.

The results of this survey show that a majority of farm leases in the Northern Extension District are oral leases (62%). Written leases were more common in Loudoun & Prince William counties (42%), and least common in Albemarle & Fluvanna Counties (12%).

The results of the leasing survey are presented in several tables. To acquire more survey responses for a given area, adjoining counties were combined in groups of two. Averages for two-county areas are given. Averages are also given for the entire district. Results for counties where too few surveys were received and for surveys where the county was not identified are included in the district-wide averages but are not included in regional averages.

How to Interpret Information in the Leasing Rate Tables

For each category of land type (pasture, good cropland, average cropland, and whole farm), the following information is presented.

- Number of Responses: The total number of survey responses used in calculating the average leasing rate for that region.

- Weighted Average Leasing Rate: The average leasing rate for each region was calculated by dividing the total dollars spent per acre per year by the total acres leased per year for a given region.

[1] No surveys were received back from Caroline, Nelson or Rappahannock counties. Due to an administrative error, Fauquier County was not included in the counties surveyed. Counties that were missed or for which incomplete information was obtained will be surveyed again in fall 2005.

- Minimum Rate: The lowest rate paid per acre per year for that region. Note: respondents who indicated that they did not pay/receive any rent for land were not included in the average rate, are summarized in another table).
- Maximum Rate: The highest rate paid per acre per year for that region. Statistical outliers have been removed.

- Median Rate: The median is the rate that is in the middle of all of the rates given for that region; that is, half the rates are above the median, and half have rates that are below. The median takes the number of responses into account, where the weighted average does not.

Table 1: Northern District Pasture Rental Rates (Cattle)

Region	Number of Responses	Weighted Average Leasing Rate (per acre – per year)	Minimum	Maximum	Median
Loudoun & Prince William	10	$22.63	$10.00	$33.21	$22.50
Spotsylvania & King George	*Insufficient Data*				
Orange & Louisa	10	$18.30	$2.50	$35.00	$16.00
Madison & Greene	18	$18.44	$6.00	$50.00	$20.00
Albemarle & Fluvanna	7	$10.28	$4.00	$24.67	$13.33
Northern District	**54**	**$17.66**	**$2.50**	**$50.00**	**$20.00**

Responses indicating that pastures were part of a horse boarding lease were excluded from these results, due to the differences in services being provided by the landowner.

Often landlords and tenants include terms for specific services to be provided by either party, as a term of the lease agreement, in addition to cash/land terms. Table 2 summarizes the percentage of pasture leases in this survey for which the services listed were provided. In addition to the services which were surveyed, several respondents indicated that mowing/brush-hogging services were commonly provided by the tenant.

Table 2: Non-Cash Services Included in Pasture Leases (percent of pasture leases)

	Tenant – Provided Services			Landlord – Provided Services		
Region	Weed Control	Fertilizer	Minor Fence Repair	Herbicide	Fertilizer	Fencing Supplies
Loudoun & Prince William	34%	28%	34%	3%	7%	17%
Spotsylvania & King George	Insufficient	Data				
Orange & Louisa	45%	55%	25%	0%	18%	23%
Madison & Greene	61%	81%	71%	3%	10%	23%
Albemarle & Fluvanna	33%	56%	67%	11%	33%	22%
Northern District	**39%**	**51%**	**46%**	**5%**	**13%**	**19%**

Table 3: Northern District Cropland Rental Rates					
Good Cropland*					
Region	Number of Responses	Weighted Average Leasing Rate (per acre – per year)	Minimum	Maximum	Median
Loudoun & Prince William	4	$53.91	$30.00	$75.00	$47.50
Spotsylvania & King George	8	$51.23	$9.25	$90.00	$37.50
Orange & Louisa	7	$32.05	$6.25	$75.00	$50.00
Madison & Greene	7	$23.86	$10.00	$33.33	$25.00
Albemarle & Fluvanna	4	$19.17	$12.50	$23.81	$19.73
Northern District	**32**	**$41.18**	**$6.25**	**$90.00**	**$30.00**
*Good Cropland was defined as having Class 1 or 2 soils					
Average Cropland*					
Region	Number of Responses	Weighted Average Leasing Rate (per acre – per year)	Minimum	Maximum	Median
Loudoun & Prince William	7	$18.95	$1.00	$60.00	$20.00
Spotsylvania & King George	5	$20.57	$15.00	$30.00	$20.00
Orange & Louisa	3	$13.95	$10.00	$15.00	$10.00
Madison & Greene	6	$13.15	$6.00	$30.00	$18.00
Albemarle & Fluvanna	4	$19.07	$8.00	$86.67	$22.50
Northern District	**28**	**$18.38**	**$1.00**	**$86.67**	**$20.00**
*Average Cropland was defined as having Class 3,4 or 5 soils and included responses identified as hay land					

Table 4: Northern District Whole Farm Rental Rates					
Region	Number of Responses	Weighted Average Leasing Rate (per acre – per year)	Minimum	Maximum	Median
Loudoun & Prince William					
Spotsylvania & King George					
Orange & Louisa	7	$21.78	$6.80	$50.00	$17.00
Madison & Greene	6	$21.87	$12.50	$30.00	$25.00
Albemarle & Fluvanna					
Northern District	**24**	**$18.93**	**$6.80**	**$50.00**	**$18.99**
Whole Farm leases were defined as those that included use of an entire farm unit, including buildings, cropland and pastures. The types of farms being rented as whole farms included in these results were cattle farms, crop farms, or crop and forage farms. Dairy farms and horticultural farms were excluded from these results due to the differences in infrastructure needs for those types of farms. There were insufficient responses for a separate categorization for these types of farms.					

Land is occasionally leased without the exchange of cash. The reasons for a non-cash lease vary from situation to situation. Often times these are small tracts of land, neighbor to neighbor, or intra-family transactions, where there is little incentive or desire to exchange cash. In other cases, non-cash services, such as fence maintenance, brush-hogging/mowing, and farm road repairs are used in the place of cash. A few respondents reported receiving hay for their horses, in lieu of cash rent for the balance of the land used by the tenant. Several respondents also cited the qualification for use-value taxation as sufficient incentive for leasing land. Table 5 summarizes the percentage of total land by use category, which was leased at no charge, as reported in the survey.

Table 5: Northern District Land Leased at No Cash Charge		
Land Category	Acres leased at no charge	Percent of total in category
Pasture	231	5
Good Cropland	92	3
Average Cropland	377	27
Whole Farms	453	10
Total all categories	**1153**	**8**

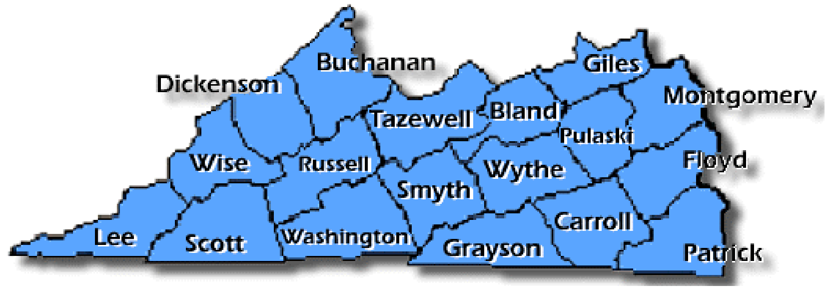
The term of a lease is very important. Longer leases allow justification for tenants to provide higher levels of capital investment on a piece of leased property, such as lime, fences, and other improvements. Shorter leases allow for greater flexibility on the part of both the tenant and the landlord to terminate a lease arrangement in a shorter period of time.

Table 6: Length of Farm Leases in Northern District		
Pasture	Average Length	4 years
	Minimum	1 month
	Maximum	25 years
	Median	1 year
Good Cropland	Average Length	3 years
	Minimum	1 year
	Maximum	25 years
	Median	1 year
Average Cropland	Average Length	1 year
	Minimum	1 year
	Maximum	5 years
	Median	1 year
Whole Farms	Average Length	3 years
	Minimum	1 year
	Maximum	12 years
	Median	1 year

For more information on the topic of farm leasing in the Northern District, contact your local extension office or Keith Dickinson, Extension Agent for Farm Business Management, who is based in the Culpeper Extension Office, at (540) 727-3434, Keith.Dickinson@vt.edu.

2005 Land Lease Survey Report for Southwest Virginia

By Daniel Osborne, (daosbor3@vt.edu), Extension Agent, Farm Business Management, Smyth County



In early 2005, Virginia Cooperative Extension conducted an agricultural land leasing survey in its Southwest District counties. About 5,400 surveys were mailed out to farmers and landowners in Southwest Virginia, and 211 responses were recorded. The results of the survey are summarized below. Because the fair value of land rent varies significantly with the circumstances, the information is intended for reference purposes only. For more information on farmland leasing, contact your local Farm Business Management Extension Agent.

Table 1: All of Southwest Virginia

Land Type	Responses	Rate*** Average	High	Low
Pasture	164	$22.47	$100.00	$2.00
Cropland	66	$32.59	$100.00	$5.50
Whole Farm*	106	$23.91	$83.00	$2.00
Tree Farms & Orchards	14	$125.32	$225.00	$5.00
Stocker Cattle Rate Per Head Per Month	12	$5.02	$10.00	$2.00
Cow/Calf Pairs Rate Per Head Per Month	21	$7.77	$12.00	$3.00
Average Length of Written Leases			43 Months	
Average Length of All Leases			**21 Months	

* "Whole Farm" generally includes buildings, cropland, and pasture rented as a single unit; however, tree farms and orchards were excluded from this category and reported as a separate item.
** Oral leases are not legally enforceable for more than one year at a time; therefore, responses that reported an oral lease for more than one year were changed to 1 year.
*** The rates are reported on a per acre per year basis unless otherwise specified.

Table 2: Bland, Smyth, Wythe & Washington County Region

Land Type	Responses	Rate*** Average	High	Low
Pasture	37	$22.17	$100.00	$8.86
Cropland	18	$36.42	$70.00	$7.50
Whole Farm*	35	$24.31	$83.00	$10.00

Table 3: Coalfield Counties Region
Dickenson, Lee, Russell, Scott, Tazewell, & Wise Counties

Land Type	Responses	Rate*** Average	High	Low
Pasture	29	$20.31	$60.00	$2.00
Cropland	5	$25.17	$48.00	$8.00
Whole Farm*	22	$17.98	$60.00	$2.00

Table 4: Carroll, Grayson & Patrick County Region				
		Rate***		
Land Type	Responses	Average	High	Low
Pasture	40	$30.44	$100.00	$6.67
Cropland	18	$31.00	$100.00	$10.00
Whole Farm*	15	$24.41	$60.00	$7.25

Table 5: New River Valley Region Floyd, Giles, Montgomery & Pulaski Counties				
		Rate***		
Land Type	Responses	Average	High	Low
Pasture	39	$20.07	$85.71	$6.40
Cropland	11	$17.07	$40.00	$5.50
Whole Farm*	22	$26.98	$60.00	$6.40

<u>Other Results</u>

Landowner or tenant: About 49% of those responding said they were owners of the land being reported, and 51% said they were the tenants. Several said that they both owned land that was being rented and were renting other land.

Oral or Written: Only 27% of the leases reported were written, leaving the other 73% as oral leases. Twenty oral leases were reported as having terms longer than one year, which means that they were not legally enforceable. Virginia law requires leases with terms for more than one year to be written to be legally enforceable. To be legally enforceable, Virginia law also requires leases to be written if the total payments are more than $1,000, excluding payments for options to renew or purchase.

Tenant Obligations: The results of this survey showed the following for tenant obligations as part of the lease agreement: 28% were responsible for weed control, 31% were responsible for fertilizer which included lime in a few cases, and 37% were responsible for minor fence, corral, and/or building repairs. These results contradict previous surveys which showed that the tenant was responsible for weed control, fertilizer, and minor fence, corral, and/or building repairs in over 70% of the leasing arrangements. The author feels that the poor design of the survey instrument led to the under reporting of tenant obligations and believes that results from previous surveys hold more merit on this issue.

Landowner Obligations: The results of this survey showed the following for landowner obligations as part of the lease agreement: 6% were responsible for providing herbicides, 8% were responsible for providing fertilizer, and 16% were responsible for providing fence building supplies. Here again, the author feels that the poor design of the survey instrument may have led to an under reporting of landowner obligations.

Getting the Most Out of the Tobacco Quota Buyout

By Dixie Watts Reaves, (dixie@vt.edu), Associate Professor, Agribusiness Management and Marketing, Agricultural and Applied Economics, Virginia Tech

On Saturday, May 28, Virginia Cooperative Extension, North Carolina Cooperative Extension, and the Institute for Advanced Learning and Research jointly offered an educational program for recipients of tobacco buyout funds. The six-hour workshop, supported by the Risk Management Agency and additional sponsors (Edward Jones, First Citizens Bank, Davenport and Company

LLC, and First Investors Consulting Group) provided detailed information on the tax implications of the buyout, investment options for buyout recipients, and options for alternative or supplemental enterprises in the post-buyout marketplace. The program was videotaped and can be viewed at http://2gdn.net or utilizing the direct link, http://164.106.50.133/Events/IALR/Tobacco_Buyout.htm .

Justin Hendrix of the Institute welcomed participants and served as the overall moderator for the day. He introduced Virginia Delegate Robert Hurt for opening comments.

Following Delegate Hurt's remarks, Arnold Oltmans, with the Department of Agricultural and Resource Economics, North Carolina State University, provided a discussion of the tax implications of the buyout. He indicated that the grower payments would be treated as ordinary income and the owner payments as capital gains. He urged both growers and owners to begin working with their tax professionals early and to begin collecting the necessary historical records to document their basis in the quota. Owners have the option of deferring their capital gains tax by utilizing a like-kind exchange. The timeframe for utilizing the exchange is limited and strict guidelines must be adhered to. Recipients will also have an option of choosing a lump sum payment after the first year. Financial institutions will offer a discounted lump sum, in return for receiving the future annual payments. Recipients are responsible for paying taxes at the time they receive the lump sum payment. When considering lump sum opportunities, Oltmans suggests asking the financial institution, "What interest rate are you charging me?" If the recipient can invest those funds at a rate higher than that interest rate, or if he/she can pay off a higher interest rate debt, then it is a good deal from an economic perspective. However, taxes will still have to be considered, and the tax effects will depend on the amount of the payment, the basis in the quota, other taxable income the recipient has, and filing status. Every individual's situation will be different; there is no simple answer to the question, "Should I take the lump sum?" Tobacco buyout details can be found at the Department's website: www.tobaccobuyout.cals.ncsu.edu .

Alex White, Department of Agricultural and Applied Economics, Virginia Tech, addressed the question of what to do with the buyout money. He presented six options for the use of the money. First, the recipient must pay taxes. Payment of taxes is not optional; however, tools to help reduce the amount of taxes paid include SEP, SIMPLE, 401(k), Keogh, and IRA's. Second, buyout dollars can be used to build liquidity. As a rule of thumb, an individual should have two to six months of living expenses as a financial safety net. Third, funds could be used to pay down debt and reduce pressure on cash flow. A fourth option is to invest in farm assets. Before doing so, the recipient should be clear about goals, should examine markets and productive capacity, and should compare the return on those farm assets to the return that could be achieved from a non-farm investment. Fifth, recipients should also consider investing in themselves and their families. Core values and goals will help recipients decide on a percentage of the buyout funds that should be invested in family goals. Finally, recipients could invest in non-farm assets. Prior to making choices about the type of investment, one must know the purpose and time frame for the investment (growth or income) and must understand his/her risk tolerance. Investment assets include stocks, bonds, mutual funds, real estate, and other investments. As the potential returns increase, the level of risk generally increases also. According to White, the basics of investing include clearly defining the investment goal, choosing the appropriate asset in terms of time horizon, risk tolerance, and earnings goal, and spreading the investment over different classes of assets.

During lunch, a panel of representatives from financial institutions provided insights into their firms and the types of products and services they offered. Panelists included Ryan Garrett (Edward Jones), Cleighton Hilbert, Jr. (Davenport and Company), Eddie Herndon (First Citizens Bank),and Pamela Bryant (First Investors Consulting Group).

The workshop closed with a panel discussion, moderated by Dixie Watts Reaves, Department of Agricultural and Applied Economics, Virginia Tech, focusing on alternative market development opportunities for producers. John Hall, Department of Animal and Poultry Science, Virginia Tech, offered insights into the potential for increased cattle production in Southside Virginia. Drew Arnn, Department of Forestry, Virginia Tech, discussed options for long-term forest investments on the farm. Joyce Latimer, Department of Horticulture, Virginia Tech, discussed a number of options for uses of greenhouse space for bedding plants and other floriculture products. Andy Hankins, Virginia State University, discussed a number of non-traditional enterprises that producers might consider adding to their farm operations. Denise Mainville, Department of Agricultural and Applied Economics, Virginia Tech, closed the panel with a discussion of risk management options for the producer. Each panelist's presentation can be viewed at http://164.106.50.133/Events/IALR/Tobacco_Buyout.htm .

With the deadline for signing up to receive buyout payments in mid-June, many growers and owners can now turn their attention to how to use the buyout dollars most effectively when they arrive in the next few months. Whether recipients choose ten years of annual payments or a lump sum, the buyout provides an opportunity for wise investing.

Five Mistakes to Avoid With Your Tobacco Buyout[2]

By Brian Lacefield, (blacefie@uky.edu), Agricultural Extension Specialist, Agricultural Economics, University of Kentucky at Hopkinsville

On October 22, 2004 President Bush signed into law a bill ending the price support of tobacco through production control. This has become known as the "tobacco buyout" and eliminates the quota system. Current quota owners and active producers during the past three years will receive payments. The quota owner will receive payments of $7/lb. and growers will receive $3/lb. based on the 2002 quota. The money will be paid by the tobacco companies and administered by the USDA in ten annual payments.

Quota owners and growers totaling over 150,000 in Kentucky will receive $2.5 billion from the buyout. Provisions in the law allow recipients to get a discounted lump sum through a third party, such as a lending institution. Regardless of whether you are taking an annual payment or lump sum, you are dealing with a unique cash inflow. Five mistakes you must avoid to get the most out of your buyout are:

[2] This article first appeared in the Economic and Policy Update; Vol. 5, No. 5; May 20, 2005; Cooperative Extension Service, University of Kentucky – College of Agriculture; Edited by Craig Infanger and is used with permission of the author. http://www.uky.edu/Ag/AgEcon/blueshee.html

1. **Failure to sign up –** Sign up is currently underway. You must sign up by June 17, 2005 to be eligible for your payments. Also, you must sign up in each county that you raise tobacco in.

2. **Getting in too big of a hurry –** When making a decision on whether to take your payment over 10 years or take a lump sum, many factors need careful consideration. All recipients must take the first annual payment before September 30th. Take your time to get all the information before making an irrevocable decision. If you are considering taking a lump sum, make sure you compare discount rates and fees to make sure you are getting the best deal.

3. **Making poor investment choices –** When evaluating lump sum or annual payments, it is important to consider what you will do with the money.

   During conversations I have had with buyout recipients, one common statement I have heard is "I will buy land and not pay any tax." The quota payment may qualify for a like kind exchange (1031 Exchange), the grower payment will not. This will translate to a maximum tax deferral of 15%, the current maximum long term capital gains rate. The like kind exchange only defers tax. When you sell the new property you will realize the federal tax and also Kentucky tax. The buyout payments are not subject to Kentucky State tax. However, the proceeds from a like kind exchange will be subject to the state tax. Paying too much for your exchange property negates the tax advantage.

   Another option I have heard and suggested to recipients is paying down debt. This is an excellent strategy for high interest debt. Taking a lump sum with a discount rate of 5.5% and paying off debt at 8% is a good deal. Taking the lump sum at a 6% discount rate and putting it in a money market account with a 2.5% return is not a good deal.

4. **Mental accounting –** Mental accounting is a behavioral economics term that refers to the tendency of individuals to categorize and treat money differently depending on where it comes from (Example: Spending $20 found in the parking lot with less thought than $20 from your paycheck). Use of mental accounting can affect a person's marginal spending rate, often exceeding one. This means that a person given $100 as a gift may end up spending $150 "justifying" purchases. Be aware of this tendency and try to manage and control them. I know it is difficult. I have been studying this for 10 years and I have an ionic air freshener, bought with cash from my Grandmother, that I see every morning reminding me to watch my mental accounting.

5. **Going it alone –** This last mistake could lead to making the previous four in addition to costing you extra in taxes. Everyone's tax situation is unique. I cannot stress enough the importance of getting competent help with making decisions with lump sum options. There are different tax treatments for different options. What is the best option and strategy for your neighbor or brother-in-law may not be your best option. Talk with your tax practioner, C.P.A., tax attorney, financial planner, and farm analysis specialist to evaluate your options and your best strategy.

The tobacco buyout is a once in a lifetime event. With this money, quota owners and growers have an opportunity to increase their net worth, invest in their operation, and/or pursue other ventures. Regardless of your decisions, I encourage you to do something so that 10 years from now you can say "I am better off today because of the money from tobacco buyout." I end this with three of my favorite quotes concerning saving and thrift:

"An investment in knowledge always pays the best interest." – Ben Franklin

"You cannot keep out of trouble by spending more than your income." – A. Lincoln

"If you don't need it, don't buy it." – Rush Midkiff

Tobacco Buyout and Tax Issues

By L. Leon Geyer, (geyer@vt.edu), Professor, Agricultural Law, Agricultural and Applied Economics, Virginia Tech

The American Jobs Creation Act of 2004 signed into law on October 22, 2004, created authority for farm producers and quota holders to receive funds for quota and production rights in tobacco. The repeal of the tobacco price support program has major tax and financial implications for farmers, quota holders, and those who serve the farmers needs.

Under the legislation, the quota holder is to receive $7.00 per pound based upon quota held in 2002 and producers are to receive $3.00 per pound of tobacco based upon their production in the 2002, 2003 and/or 2004 crop. Many farm producers owned quota as well as rented additional quota tobacco from relatives, neighbors, and other quota owners. For example, if Grandma Kent owned 1,000 lbs. of tobacco quota and rented the quota to her grandson Winston, Grandma Kent will receive $700 a year for 10 years and Winston will receive $300 per year for 10 years for his production rights to the quota. If Winston also owned 2,000 lbs. of quota, he will receive $2,000 per year for his quota and production rights ($1,400 for the quota and $600 for production of the quota). In our example, Grandma will receive $700 and Winston $2,300. But how will each report the income for tax purposes from the tobacco buy out?

The $3.00 ($900) a pound paid for loss of tobacco production to Winston is ordinary income. Winston will report the $900 on his schedule F. Thus the $900 is subject to self employment tax and ordinary income tax.

Because tobacco quota is an interest in real estate, it is treated as §1231 asset used in a trade or business. If the quota was held for more than a year, the gains are treated as capital gains and losses are treated as ordinary losses. Therefore, Grandma Kent will report the $700 each year as a capital gain and Winston will report $1,400 as a capital gain. They will have to subtract their basis in their quota from the buyout payments to determine their capital gain.

The following examples are illustrative of the tax consequences of the payments provided to procedure and quota holders, including how to determine basis. Since quota is an interest in land a Sec. 1231 asset, the gains (or losses) are reported on Form 4797.

1. **Tax Issues for the Production Payments ($3/lb.)**

Example 1:

- Dusty Lief produced 1,000 lbs. of tobacco under quota.
- Dusty Leif will receive $30,000 over ten years or $3,000 per year.
- Assume Dusty's marginal tax rates: 25% federal, 5.75% state, and 15.3% SE tax*
- Marginal Tax is 46.05%; therefore, Dusty will pay $1,381.50 in total taxes on $3,000 income annually for the ten-year period.
  *SE taxes are adjusted to 92.35% of earnings.

2. **Basis of purchased Quota**

Leif Brown purchased quota. What is his basis to calculate capital gains? **What he paid for quota is his basis.**

Example 2:

- Leif Brown purchases 5,000 lbs. for $2.00 per pound.
- Basis is $10,000 in the "lot" or "block" of quota.
- Avg. prior reduction in quota changes the basis per pound, not basis per "lot."
- If Leif's still has the 5,000 lbs. of quota, his basis $2.00 per pound. If Leif's basis were reduced by 20%, he would have 4,000 lbs. of quota and $2.50 per pound of quota.

3. Basis of Quota if inherited.

Jane Jones inherited quota from her father. What is her basis to use to calculate her gain on the quota? Quota basis is stepped up to the fair market value (FMV) at the date of death or alternate valuation date (6 months after death) of Jane's father. **Jane's basis is stepped up to fair market value on date of decedent's death.**

Example 3:

- Jane Jones inherits quota from Father.
- FMV at date of his death was $50,000 for land and 7,500 lbs. of quota.
- Land was worth $35,000 without the quota.
- $15,000 is the value of tobacco quota ($2/lb.).
- If Jane's quota was reduced by 30%, her 5,250 lbs. of quota is worth $15,000 or $2.86 per lb.

4. **Quota Basis if quota was previously amortized**.

Bob Smith amortized quota in 1994. What is his basis in the quota today?

Bob's purchase price of quota (original basis) is adjusted downward by the amount he amortized.

Example 5:
- Bob Smith amortized quota in 1994.
- Bob bought quota in January 1994 for $10,000. He deducted $333 for one year's amortization on his 1994 tax return.
- Adjusted basis is now $9,667, not the $10,000 he paid for the quota.

5. Quota Basis with no record of value at time of death or what I paid for it.

If one has no records,

a. Good faith effort must be made that is reasonable. IRS default position is no records, basis is zero.
b. Historical data may be available and helpful.
c. Other sources may be used.
    1. Permanent farm records of others.
    2. County Commissioner of Revenue office.
    3. Real Estate Agents.
    4. USDA
d. For example, if neighbors paid $1.50 a pound in the year that Grandpa died, then his 5,000 lbs. of tobacco quota was worth $7,500.

6. Example 6:

No Records

a. Dyrt Clodd bought 100 acre farm for $185,000 and did not make allocation of basis to land and quota. Historical records show quota sold for $1/lb. and the farm had 800 pounds per acre attached at time of purchase. $80,000 of quota basis might be argued to be reasonable and the balance, $105,000 is allocated to the land.
b. Dad died in 1995. What did others pay for quota that year? If you can establish that neighbors paid $1.75 to $1.85 for quota, then $1.80 per pound would be reasonable.
c. If you were the original owner of quota given to you by the government, your basis is zero.

7. Capital gain calculation

Example 7. Lisa Holder owns 25,000 pounds of tobacco quota. Her basis is $30,000 or $1.20 per lb. As an owner of quota, Lisa will receive $175,000 over ten years with an annual payment of $17,500.

Gain is calculated by subtracting her basis

a. $175,000 - $30,000 = $145,000 ($14,500/year)
b. And treated as capital gain of $14,500/year
c. $30,087.50 in taxes (assuming 15% federal capital gain rate and 5.75% state income tax rate)

8. Production and quota gain calculation

Philip Reynolds raised 12,000 lbs. of tobacco in 2002 and 14,000 lbs. in 2003.

a. Philip owned 10,000 of quota and rented 2,000 and 4,000 lbs. (2002 & 2003).
b. Philip purchased 5,000 lbs. for $3.00 and inherited 5,000 lbs. when tobacco quota was selling for $1.00 per pound.

Computation of income

Capital gain

i. $35,000 – $10,000 = $25,000/10 = $2,500
ii. $35,000 – $5,000 = $30,000/10 = $3,000

Ordinary income

c. $36,000/10 = $3,600 (x tax rate & SE)

9. Like kind exchange and tobacco buy out.

Arguably tobacco quota is an asset that qualifies for I.R.C. §1031 like-kind exchange. Real property is an interest in land. Several letter rulings allow for like-kind exchange of interests in land for other real property.

Two primary rules must be followed:

a. Money paid for relinquished property must be held by a qualified intermediary until used to purchase replacement property.
b. Strict time limits must be met: replacement property must be identified in 45 days from transfer date.
c. Replacement property must be acquired within 180 days from transfer date
d. Legislation is silent as to §1031 exchanges and transfer date. Transfer date arguably is when consideration is received by either the qualified intermediary or the taxpayer.
e. A like-kind exchange is more easily executed with a lump-sum payment. Like-kind exchanges can be executed with mortgages and installment contracts but are very messy.

Property that Qualifies for §Sec. 1031 Exchange includes the following:

- Quota for farm
- Quota for timberland
- Quota for Beach Rental unit
- Quota for rental 4-Plex
- Quota for a commercial rental office building

10. **Farmers could also use the buyout money as follows**:

a. Reduce debt and phase out of tobacco
b. Expand farm with purchase (use of §1031)
c. Enter into new business activities

d. Gift to family or charitable organizations
e. Diversify family income stream (invest)
f. Retirement
g. Other options

11. **The legislation allows for securitization of quota payments**.
    a. A third party (financial institution) may offer to quota owners a lump-sum payment at a discount.
    b. The present value and tax consequence must be evaluated for such a transaction.
    c. The lump-sum will retain the character of income as the original payment stream: capital gain and production payments on a pro-rata share basis.

12. Other issues

Some Virginia counties have had a property tax on tobacco quota. Since the tobacco quota no longer exists as an asset, the property tax value, if any, should become zero. Tobacco is grown in 22 percent of Virginia counties. In jurisdictions with tobacco quota, 47 percent considered the add-on quota value when assessing the use-value of agricultural land. The rest (53 percent) do not. You should check with your county or city governments to make sure that quota property taxation is removed, since quota no longer has value.

Quota payment dollars do not qualify for farm income averaging payments and payments will be reported on forms 1099-gov. Farmers should consult their CPA or tax practitioner as well as their financial advisors in managing both taxes and the long-term consequences of the tobacco buyout.

For additional information, see
http://www.ag-econ.ncsu.edu/faculty/vanderhoeven/guido.htm

a. Tobacco Quota Buyout and Potential Tax Consequences and Planning Opportunities 10/22/2004
b. Homework: Calculate Tobacco Quota Basis 2/20/2003
c. Net Present Value Calculator for Lump Sum Options for the Tobacco Quota Buyout 10/28/2004
   Using the Tobacco Net Present Value Calculator

For further information on operations of the tobacco buyout program, consult your Farm Service Agency and Farm Management Agent.

Virginia Law for Farmers and Landowners: What's New from the 2005 Legislative Session

By [L. Leon Geyer](), ([geyer@vt.edu]()), Professor, Agricultural Law, Agricultural and Applied Economics, Virginia Tech

The legislature was active in passing laws that impact upon farmers and other landowners. Several of these important laws are summarized below.

1. Fence Law - Fence law and its application are often the subject of neighborly disagreement. Under current law, owners of subdivided (homeowners and small lot owners), commercial, or industrial property which border farms could be forced to pay for half of the boundary fence in Virginia. Farmers who owned un-subdivided land such as 400 acre apple orchard or 200 acre soybean farm were not required to pay for half of a fence between them and a livestock farmer. A new law, embodied in HB1648, modifies Virginia's fence law governing the construction of division fences. The new law allows all adjoining landowners to a livestock farmer to let their land lay open and thereby avoid having to contribute half of the cost of a boundary fence. The revised fence law is effective July 1, 2005.

Important points about the revised fence law include

A. Adjoining property owners can agree among themselves to share the cost. Some property owners may have such agreements already recorded with land records. Prior recorded agreements as well as current agreements to share the cost are enforceable.

B. Homeowners; developers; golf courses; commercial; industrial; timber; and fruit, vegetable, and crop farms are not required to pay for half of the fences for adjoining livestock producers beginning July 1, 2005

C. By implication, adjoining livestock farmers or landowners whose land is used for livestock production must share in the erection of fences that enclose the land for agricultural purpose.

D. The cost of fencing to a farmer is recovered under the tax code as a Section 179 expense or on the farmer's depreciation schedule.

E. Under current law, homeowners added the cost of the fence to the property basis and recovered it, if at all, upon the sale of the property. Since most homeowners do not pay capital gains taxes upon the sale of the house, it had no tax benefit.

Selected sections of the current fence law are outlined below.

Virginia Code §55-317. Obligation to provide division fences.

Adjoining landowners shall build and maintain, at their joint and equal expense, division fences between their lands, unless one of them shall choose to let his land lie open ~~as hereinafter provided for~~, or unless they shall otherwise agree between themselves. ~~No owner of land used for industrial or commercial purposes, or subdivided into lots or parcels, adjoining lands used for agricultural purposes, when given notice by the owner of such adjoining lands under §55-318 shall have the option of choosing to let his land lie open, but shall build one half of such fence or be liable therefore.~~

~~Proceedings for the erection and repair of such fences shall be as set forth in the following sections.~~

[Material lined out was removed from the statute by H 1648]

Virginia Code § 55-318. When no division fence has been built.

When no division fence has been built, either one of the adjoining owners may give notice in writing of his desire and intention to build such fence to the owner of the adjoining land, or to his agent, and require him to come forward and build his half thereof. The owner so notified may, within ten days after receiving such notice, give notice in writing to the person so desiring to build such fence, or to his agent, of his intention to let his **land lie open**, in which event, and if the one giving the original notice shall build such division fence and the one who has so chosen to let his **land lie open**, or his successors in title, shall afterwards enclose it, he, or they, as the case may be, shall be liable to the one who built such fence, or to his successors in title, for one-half of the value of such fence at the time such land shall be so enclosed, and such fence shall thereafter be deemed a division fence between such lands.

If, however, the person so notified shall fail to give notice of his intention to let his **land lie open**, as hereinabove provided, and shall fail to come forward within thirty days after being so notified, and build his half of such fence, he shall be liable to the person who builds the same for one-half of the expense thereof, and such fence shall thereafter be deemed a division fence between such lands.

Notwithstanding the provisions of this section, no successor in title shall be liable for any amount prior to the recordation and proper indexing of the original notice in the clerk's office of the county in which the land is located.

The other legislative enactments are likely to have a lesser impact on farmers and landowners.

2. Pesticide Control Board – Current law required one member of the Board to represent commercial applicators. Under new legislation, at least one of the two appointees representing the commercial sale or application sector must be a structural commercial applicator. (HB 1644)

3. Referendum on whether to levy excise tax or assessments were enacted for Apples, Horse and Cotton industries.

   a. Apple industry. Board of Agriculture and Consumer Services is authorized to hold a referendum on the levy of an excise tax of 2.5 cents per tree run bushel of ungraded apples grown in the Commonwealth for sale by producers of at least 5,000 tree run bushels per calendar year. The bill defines "tree run bushel" as a bushel of harvested apples that have not yet been graded or sized. HB 1746

   b. Horse industry. Board of Agriculture and Consumer Services, upon petition, is authorized to conduct a referendum of horse owners in the Commonwealth on the question of whether or not an assessment of $3 per ton or 7.5 cents per 50-pound bag of manufactured horse feed should be established to support additional market development, education, publicity, research, and promotion of the equine industry. HB 2423

   c. Cotton industry. Board of Agriculture and Consumer Services, upon petition, is authorized to conduct a referendum of cotton producers in the Commonwealth on the question of whether or not the Cotton Board should be authorized to increase the current assessment of $0.85 per bale of ginned cotton by a maximum of $0.15 to support education, research, and promotion of the growth and use of cotton. HB 2737

4. Agricultural Enterprise Act of 2005 directs the Department of Agriculture and Consumer Services (VDACS) to establish, as an element of the Office of Farmland Preservation, agricultural enterprise districts upon application by localities with established agricultural or forestal districts, locally designed agricultural enterprise districts, or purchase of development rights programs.

   "Qualified agricultural businesses" and "qualified farm businesses" located in such districts may apply to VDACS for assistance in developing a new business plan and grant funding for up to 50 percent of the associated costs of implementing that plan, up to a maximum $500,000. "Qualified agricultural businesses" are agricultural businesses that establish a new business operation or plan to expand and improve an existing operation within a designated agricultural enterprise district. "Qualified farm businesses" are farm businesses that establish a new agricultural or forestall production operation or plan to expand or improve an existing operation within an agricultural enterprise district. This bill contains a delayed enactment clause of January 1, 2007, which is conditioned upon funding for the program being included in the appropriations act for fiscal years 2006-2008. HB 1947

5. Animal Laws

   a. Animal Laws in Towns. Towns have the option of adopting by reference any ordinance of the surrounding county to be applied within its town limits, instead of adopting an ordinance of its own. HB 2221.

b. Sale of Companion Animals. Localities that adopt an ordinance to require permits for pet shops or companion animal dealers may provide either a criminal penalty not to exceed a Class 3 misdemeanor or a civil penalty not to exceed $500 for any violation of the ordinance. HB 2338

6. Right to consume farm products.

The legislature affirmed that a person, his immediate family, or his guest has a right to consume products or commodities grown or processed on his property provided that the products of commodities are not offered for sale. HB 2295

A bill to allow producers with 3 or less dairy cows or 12 or less milking goats to sell milk exempt from VDACS dairy sanitation regulations was defeated. With the affirmation of HB2295, some producers will sell a cow and services to Connie Consumer and then have Connie pick up her milk. The issue of right to sell without compliance with VDACS regulations has been a hot one for the legislature.

New from REAP

By Karen Mundy, (karenm@vt.edu), Rural Economic Analysis Program, Communications Specialist, Agricultural and Applied Economics, Virginia Tech

Describing Organic Agricultural Production in Virginia: Results of the 2004 Farm Survey
Authors: Susan B. Sterrett, Gordon E. Groover, Daniel B. Taylor, Karen Mundy. Despite the importance of organic production, Virginia producers lack information. A common criticism by organic growers is that, unlike commercial growers, applicable production, economic, and marketing information is difficult to obtain, or the information targeting conventional production is not easily transferable to organically grown products. Production budgets are necessary building blocks for many business management tools to facilitate sound production and marketing decisions. However, the great diversity of potential organic practices and the resulting integration efficiencies of combining these practices are difficult to fit into conventional budgets. Working on the premise that budgets for organically grown crops need to reflect the synergisms of practices associated with organic production, we quickly concluded that we lacked an understanding of organic production and the needs of Virginia organic producers. The result of our discussions led to a survey of Virginia farmers who are certified organic, those who are using organic practices but are not certified, and those who are transitioning to or expanding their organic production.

Our goal in surveying organic producers was to gain a better understanding of organic production in Virginia. Our objectives were to identify

- the extent of organic production in Virginia,
- the products produced and organic practices used,
- the marketing outlets used,
- the extent of certification and barriers to certification,

- demographic characteristics, and
- potential research and extension needs.

Organic production offers a cornucopia of opportunities for Virginia's farmers to diversify and to expand their businesses to meet the increasing demand for organic products. Yet understanding how to navigate this vast array of opportunities to insure a successful business that addresses the needs of consumers is not clear. A number of farmers have successfully adapted to this new market, taking risks and reaping rewards for their entrepreneurship. As the industry matures, consumers will seek more variety and higher quality, and farmers will have to increase their understanding of markets, costs, and efficiencies. Educational institutions and service providers will need to understand that their clients are not the same as traditional farmers and adapt their educational programs to meet the needs of their clients or they will seek information from other sources.

Southeast Regional Agritourism Forum

The Georgia Department of Economic Development and the University of Georgia have come together to host a three day informational forum for individuals involved in State-level Agritourism. The forum will give State-level Agritourism Programmers in the Southeast the opportunity to exchange ideas, information, obstacles, and solutions relating to the growing Agritourism industry. This forum is a great opportunity for individuals involved in agritourism planning at the state level such as the Departments of Tourism, Departments of Agriculture, and County Extension Services.

Dates: June 29-July 1, 2005
Location: University Georgia Tifton Campus Conference Center
Costs: $150 per person
Web Site: http://www.ugatiftonconference.org/agritourism/default.htm
Phone: (478) 275-6888

Calendar of Events

June

29-7/1 Southeast Regional Agritourism Forum at University Georgia Tifton Campus Conference Center. More information is available at: http://www.ugatiftonconference.org/agritourism/default.htm