

# Estimated Effects of the Tax Cuts and Jobs Act on Farms and Farm Households

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## What Is the Issue?

Federal income tax rates and tax provisions affect the after-tax income of farm households, but they may also influence economic decisions such as labor force participation and labor allocation (hours worked on and off the farm), the household's investment portfolio, and the timing of income realization. U.S. farms are overwhelmingly organized as passthrough entities, meaning income from the operation is taxed at the individual level along with the farm household's income from other sources. Consequently, farm households are affected by both individual and business income tax rates and preferences as provided by deductions, credits, deferrals, and other provisions. The Tax Cuts and Jobs Act (TCJA), passed in December 2017, significantly changed the Federal income tax system, including individual and business income tax rates, business expenses, taxable income deductions, and the alternative minimum tax. The TCJA also doubled the Federal estate tax exclusion. This report estimates the impact of current Federal income tax provisions on farm households by using 2016 tax-year data.

## What Did the Study Find?

In 2016, farms organized as passthrough entities constituted over 98 percent of family farms and 90 percent of the total value of U.S. agricultural production; thus, the biggest effects of the TCJA on farmers are from changes to the Federal individual income tax code.

**We estimate that had the TCJA been in effect in 2016, family farm households would have faced an average effective tax rate of 13.9 percent that year versus 17.2 percent** after factoring in several tax credits (Child Tax Credit, Earned Income Tax Credit, and Child and Dependent Care Tax Credit) but excluding self-employment taxes.

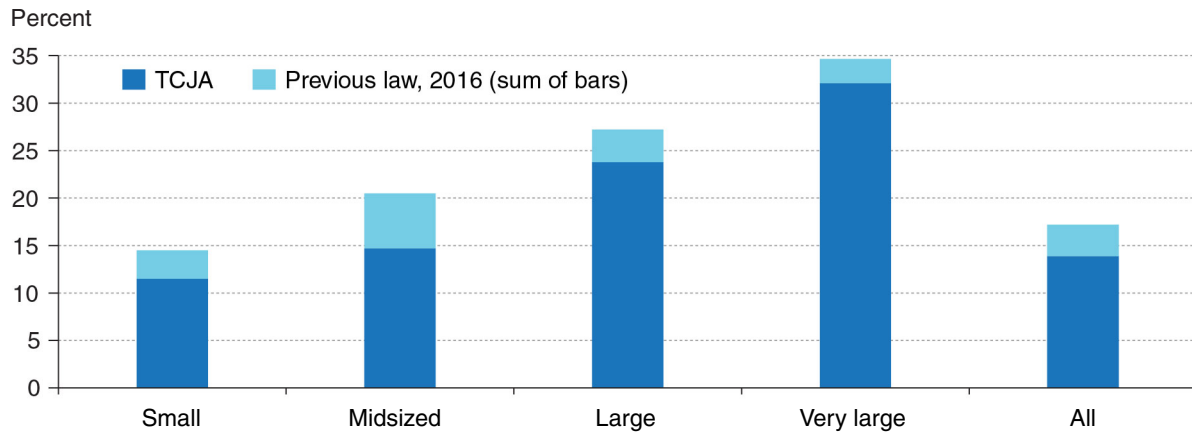
**The reduction in average effective income tax rates resulting from the TCJA would have varied across family farm sizes, with midsized and large farms experiencing greater reductions (see figure).** About 91 percent of family farms are small (less than \$350,000 gross cash farm income, or GCFI, before expenses). We estimate that the average small family farm household would have experienced a decrease of 3.0 percentage points in its effective income tax rate had the TCJA been in effect in 2016, while the average midsized (GCFI between \$350,000 and \$999,999) and large (GCFI between \$1 million and \$4,999,999) family farm households would have experienced decreases of 5.8 and 3.4 percentage points, respectively. Very large farms (GCFI greater than \$5 million) would have experienced a 2.6-percentage point reduction.

**Under the TCJA, the average farm household in each commodity specialization is estimated to experience a decline in its average effective tax rate relative to previous law, but the size**

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**of the change varies across commodity specializations.** Producers of high-value crops—fruits, nuts, vegetables, and nursery operators—and major row crops would have experienced an estimated tax rate decline of 4.0 percentage points in 2016 under TCJA. Producers of beef cattle, representing the greatest number of farms of any specialty, would have experienced a decline of 2.6 percentage points.

### Estimated effective tax rates decline for all farm sizes



Note: Data in the chart are drawn from the report's table 5 and represent estimated 2016 effective income tax rates under the Tax Cuts and Jobs Act (TCJA) and previous law. Small farms are farms with less than \$350,000 gross cash farm income (GCFI); midsized farms have GCFI between \$350,000 and \$999,999; large farms have GCFI between \$1 million and \$4,999,999; very large farms have GCFI of at least \$5 million.

Source: USDA, Economic Research Service (ERS) estimates using data from the USDA, National Agricultural Statistics Service/ERS 2016 Agricultural Resource Management Survey.

**The TCJA changes capital cost recovery provisions for purchases of equipment and other depreciable assets, but the change will likely affect only larger farms because they are most likely to make large investments in machinery, equipment, and other depreciable property/assets.** Had the TCJA been in place for 2016, less than 1 percent of large farms and 10.5 percent of very large farms (GCFI at least \$5 million) are estimated to have made investments that could not be fully deducted in the year of purchase. In contrast, under previous law, 3.5 percent of large farms and almost a quarter of very large farms had made investments in depreciable assets above the first-year expensing limit.

**Under the TCJA's new estate tax parameters, only an estimated 0.58 percent of farm estates (or 227 estates) would have been required to file an estate tax return in 2016, and only 0.11 percent (or 43 estates) would have owed an estate tax (for an aggregate estate tax liability of \$104 million).** Using the previous law's parameters, we estimate 2.05 percent of farm estates were required to file an estate tax return, and 0.86 percent of farm estates had a tax liability, resulting in an estimated \$496 million of Federal estate tax revenue in 2016.

### How Was the Study Conducted?

Using financial and demographic data for farms and farm households from USDA's Agricultural Resource Management Survey (ARMS) and data from the Internal Revenue Service, we constructed a tax simulation model to estimate family farm household adjusted gross income, taxable income, tax liability, and effective individual tax rates as well as effective marginal tax rates, under current and prior tax policies. For the Federal estate tax estimations, we computed an actuarial model using farm financial information from ARMS, mortality data from the Social Security Administration, and interest rate data from Farm Credit System lenders. This report does not account for behavioral changes by family farm households in response to the changed tax provisions; that is, we assume households would have made the same decisions in 2016 had the TCJA been in effect.