



EXPANDED 1099 AND W-2 REPORTING REQUIREMENTS TO PLACE BURDEN ON KANSAS FARMS AND RANCHES

How many different individuals or businesses does the average Kansas farm or ranch pay \$600 or more for business expenses in a year? The answer reveals the number of 1099 Forms that will soon need to be filed annually by that average Kansas farm. This requirement, along with additional information that will need to be included on the W-2 Forms of some farm employees, is part of the behemoth health care reform bill passed in late March, officially known as the Patient Protection and Affordable Care Act. Full compliance with these new provisions will be challenging.

Section 9006: Expansion of Information Reporting Requirements

This section of the health care reform bill creates new standards for 1099 reporting beginning in 2012. Historically, issuance of a Form 1099 has been required by any individual or entity involved in a trade or business (such as farming) that paid \$600 or more in a calendar year to another individual or non-corporate entity for the following types of expenses: rent, interest, and “non-employee compensation.” In production agriculture, the most common type of “non-employee compensation” is custom work. Many Kansas farms and ranches have therefore been required to issue a few 1099’s each year, while some farms currently do not have to file any. It all depends upon whether or not they are paying cash rent, interest, or custom

work in the course of their farming or ranching activities.

Section 9006 of the health care reform bill changes this by implementing two new requirements. First, corporations are no longer exempt payees for 1099 purposes. In other words, 1099 Forms will need to be issued to corporations just like anyone else. However, tax-exempt corporations may still be ignored.

The second change is much more overreaching and burdensome, as it adds a new type of expense for which 1099’s must be issued. By adding the phrase “amounts in consideration for property” to the description of expenses requiring 1099’s, Congress has increased the cost and burden of filing 1099’s tremendously. This change will have farms and ranches (and other businesses as well) spending time attempting to collect the names, addresses, and federal identification numbers for every single person or entity, other than tax-exempt corporations, to whom they paid at least \$600 for almost anything. Rent, interest, and custom work were already required payments and now Congress has added “property.” Absent further clarification, the term “property” encompasses any product the farm purchases including, but certainly not limited to, crop inputs such as seed, fertilizer, and chemicals; feed; supplies; medicine; fuel; and so on. Thus, beginning in 2012 (for 1099’s due in January, 2013), much more time will need to be put into collecting all this information. Not only will the names, addresses, and identification numbers be necessary, but the total dollar amount paid to

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each payee during that calendar year will need to be calculated. This will result in an incredible increase in time and cost, as preparation fees will presumably rise due to the vast increase in the number of 1099 Forms for which final preparation will be completed by tax prep firms other than the farms themselves. The number of 1099 Forms filed will certainly increase by a vast amount, though it is difficult to even guess how much.

Section 9002: Inclusion of Cost of Employer-Sponsored Health Coverage on W-2

Another provision of the health care reform bill affects farms and ranches that have employees for whom they are providing some form of health insurance. This new mandate requires employers to include more information on their employees' W-2 Forms. Specifically, beginning next year (for W-2's to be filed by January, 2012), employers must include the cost of health insurance premiums for employees' policies on the W-2's. The total premium cost is to be stated on the W-2 regardless of how the cost is shared between employer and employee. This does not include premiums for policies covering a specific disease such as cancer policies, long term care insurance, or accident insurance. Also, payments made to an employee's Health Savings Account (HSA) or Medical Savings Account (MSA) are excluded. This number will not be added to the employee's taxable income. It is going to be utilized by the federal government as a method of verifying health insurance coverage and tracking coverage

values for other provisions in the health care reform bill.

Summary

While at first glance the changes to 1099 and W-2 reporting may not appear to be very extensive, a closer look reveals the true burden they will place upon farmers, ranchers, and other business owners. The increased 1099 requirements of Section 9006, in particular, will be extremely time-consuming and costly to implement. It is expected to raise \$17 billion in federal taxes over the next decade as some income is reported that otherwise would not have been, due to the issuance of more 1099's. However, the compliance cost to the business community—and to the Internal Revenue Service to process and verify the income reported on all these additional 1099's—needs to be considered as well. As a matter of fact, on April 26th—just 27 days after the reconciliation of the health care reform bill passed—a bill (H.R. 5141) was introduced that would repeal Section 9006 and therefore remove these new burdensome 1099 requirements. It is currently in the House Ways and Means Committee awaiting discussion. If it is not passed, though, and 2013 arrives with Section 9006 of the health care reform bill intact, thousands more of those envelopes with the message "*Important Tax Document Enclosed*" will be arriving in mailboxes across the country. At least the United States Postal Service will be happy.

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FINANCIAL PERFORMANCE AND FARM SIZE

Financial performance often varies by farm type or farm size. This article documents differences in financial performance among farm sizes in the Kansas Farm Management Association.

The following financial performance measures

were used in the analysis: total expense ratio, adjusted total expense ratio, economic total expense ratio, profit margin, and asset turnover ratio. The total expense ratio was computed by dividing accrual expenses (cash costs, accrual cost adjustments, and depreciation) by value of

farm production. The adjusted total expense ratio was computed by adding unpaid operator and family labor to the expenses included in the total expense ratio and dividing by value of farm production. A ratio below one would indicate that a farm or group of farms is covering accrual expenses and unpaid operator and family labor. The economic total expense ratio was computed by adding the opportunity charge on net worth to the expenses included in the adjusted total expense ratio and dividing by value of farm production. A ratio below one would indicate that a farm is covering accrual expenses, unpaid operator and family labor, and the opportunity charge on net worth. The profit margin ratio was computed by adding interest and subtracting unpaid operator and family labor from net farm income, and dividing the result by value of farm production. The asset turnover ratio was computed by dividing total assets by value of farm production. In addition to reporting financial measures, this article also reports the incidence of financial stress, the percent of farms covering accrual expenses and opportunity costs, and the percent of farms in each profit margin quartile. Farms that were financially stressed were not covering accrual expenses and unpaid operator and family labor, and had a debt to asset ratio above 70 percent.

Farms in the Kansas Farm Management Association with continuous data from 2005 to 2009 were included in the analysis. Table 1 reports the averages for these 1,052 farms. The average total expense ratio, adjusted total expense ratio, and economic total expense ratio was 0.766, 0.891, and 1.064, respectively. Note that the average adjusted total expense ratio was below 1.000. This indicates that, on average, the farms were covering accrual expenses and unpaid operator and family labor. Approximately 63 percent of the farms were able to cover these expenses. In contrast, only 29 percent of the farms were able to cover all costs, including the opportunity charge on net worth. The average profit margin ratio was 0.1613 and the average asset turnover ratio was 0.3303.

Table 2 reports the financial measures for five farm size categories. The farms were sorted into size categories using value of farm production. The total expense ratio was substantially higher for the small farm size category, but similar for farms with a value of farm production greater than \$100,000. The adjusted total expense ratio was below one for farms with a value of farm production greater than \$250,000 while the economic total expense ratio was below one for farms with a value of farm production greater than \$500,000. Because they include opportunity costs, comparisons among farms using the adjusted total expense ratio and the economic total expense ratio are more appropriate than comparisons among farms using the total expense ratio. It is particularly problematic to compare the total expense ratio between a group of farms with no hired labor and a group of farms with hired labor. It is important to keep in mind that hired labor is included in the total expenses that make up the total expense ratio, but unpaid operator and family labor is not. The percent of farms with an adjusted total and an economic total expense ratio less than one increases with farm size. Approximately 63 and 70 percent, respectively, of the farms with a value of farm production between \$500,000 and \$1,000,000 and greater than \$1,000,000 were covering all accrual expenses and opportunity costs.

The profit margin ratio for farms with a value of farm production above \$500,000 was above the average profit margin ratio. Similarly, the asset turnover ratio for farms with a value of farm production greater than \$500,000 was above the average for all farms. The negative profit margin for farms with a value of farm production below \$100,000 reflects the problem these farms have in covering unpaid operator and family labor. Only 3.05 percent of the small farms were in the top profit margin quartile (i.e., in the fourth category). In contrast, over 46 percent of the farms with a value of farm production greater than \$500,000 were in the top profit margin quartile.

Financial stress was below average for the farms with a value of farm production greater than \$500,000. These farms tend to be able to cover opportunity costs on operator and family labor, making these farms relatively less financially stressed.

This article presented information on financial performance by farm size category. More

information on financial performance and the Kansas Farm Management Association can be found on the following web site:

www.agmanager.info/kfma.

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Table 1. Summary Statistics for 1,052 KFMA Farms with Continuous Data from 2005-2009.

Item	Average
Value of Farm Production (VFP)	\$389,428
Net Farm Income	\$91,276
Interest	\$20,403
Unpaid Family and Operator Labor	\$48,853
Total Assets	\$1,179,111
Total Debt	\$334,617
Total Expense Ratio (TER)	0.766
Adjusted Total Expense Ratio (ATER)	0.891
Economic Total Expense Ratio (ETER)	1.064
Operating Profit Margin Ratio	0.1613
Asset Turnover Ratio	0.3303
Debt to Asset Ratio	0.2838
Percent of Farms with Positive Net Cash Flow	94.01%
Percent of Farms Financially Stressed	5.23%
Percent of Farms with TER less than 1.000	90.78%
Percent of Farms with ATER less than 1.000	62.74%
Percent of Farms with ETER less than 1.000	29.09%
Percent of Farms with VFP less than \$100,000	12.45%
Percent of Farms with VFP between \$100,000 and \$250,000	30.80%
Percent of Farms with VFP between \$250,000 and \$500,000	33.08%
Percent of Farms with VFP between \$500,000 and \$1,000,000	17.40%
Percent of Farms with VFP greater than \$1,000,000	6.27%

Source: Kansas Farm Management Association 2009 Databank.

Table 2. Summary Statistics by Farm Size Category.^a

Item	Value of Farm Production (thousands of dollars)				
	< \$100	\$100 to \$250	\$250 to \$500	\$500 to \$1000	> \$1000
Number of Farms	131	324	348	183	66
Value of Farm Production (VFP)	\$64,923	\$175,913	\$358,058	\$678,223	\$1,446,343
Net Farm Income	\$5,960	\$35,911	\$87,487	\$175,012	\$320,208
Interest	\$5,218	\$11,102	\$18,494	\$31,194	\$76,344
Unpaid Family and Operator Labor	\$28,377	\$40,283	\$49,583	\$62,585	\$89,637
Total Assets	\$493,090	\$777,868	\$1,084,003	\$1,727,117	\$3,492,504
Total Debt	\$78,821	\$172,281	\$301,131	\$527,503	\$1,281,000
Total Expense Ratio (TER)	0.908	0.796	0.756	0.742	0.779
Adjusted Total Expense Ratio (ATER)	1.345	1.025	0.894	0.834	0.841
Economic Total Expense Ratio (ETER)	1.856	1.300	1.069	0.976	0.963
Operating Profit Margin Ratio	-0.2649	0.0383	0.1575	0.2118	0.2122
Asset Turnover Ratio	0.1317	0.2261	0.3303	0.3927	0.4141
Debt to Asset Ratio	0.1599	0.2215	0.2778	0.3054	0.3668
Percent of Farms with Positive Net Cash Flow	79.39%	92.59%	97.70%	98.36%	98.48%
Percent of Farms Financially Stressed	7.63%	7.10%	5.75%	0.55%	1.52%
Percent of Farms with TER less than 1.000	66.41%	87.65%	97.13%	98.36%	100.00%
Percent of Farms with ATER less than 1.000	12.98%	42.59%	78.45%	92.90%	93.94%
Percent of Farms with ETER less than 1.000	0.76%	8.64%	33.33%	62.84%	69.70%
Percent of Farms in First Profit Margin Quartile	83.21%	40.12%	6.03%	1.64%	0.00%
Percent of Farms in the Second Profit Margin Quartile	9.92%	33.02%	28.16%	16.39%	22.73%
Percent of Farms in the Third Profit Margin Quartile	3.82%	15.12%	37.07%	32.79%	30.30%
Percent of Farms in the Fourth Profit Margin Quartile	3.05%	11.73%	28.74%	49.18%	46.97%

^a Farms in the first profit margin quartile have the lowest operating profit margin ratio. Farms in the fourth profit margin quartile have the highest operating profit margin ratio.

RECOMMENDATIONS FOR FURTHER READING

The purpose of this section of the newsletter is to briefly discuss articles and web sites that may be of interest to readers. In general, the articles

discussed will not report on original research. Rather, the articles will contain citations to web sites and articles that discuss topics of general

interest.

KFMA enterprise summary information for each association and the state has now been posted to the KFMA web site (www.agmanager.info/kfma). In addition to enterprise summaries; historical returns, effective price trends, and enterprise profit third information can be found on this web site.

A recent issue of the *Animal Science Monitor* (Issue 104), written by Don Hunter, discusses the importance of the interview process. Though written from the perspective of an employee, the article should also be of interest to employers. When a company is hiring an individual they are trying to determine whether the person is a good fit. From the perspective of an employee, the author stresses the importance of branding yourself the right way. Specifically, the author stresses the importance of being honest, effectively communicating your decision in a timely fashion if you are considered for the job, and not “burning any bridges”. If a person does not get the job with the company, it is possible they might be considered for future jobs or that the employer tells another company that you would be a good fit for their organization. Issues of the *Animal Science Monitor* can be accessed via the following web site:
www.animalsciencemonitor.com.

Linda Smith recently summarized a survey of producers with \$250,000 income or more conducted by Rabobank this spring on the

AgWeb.com web site. For purposes of the survey, Kansas was included in the Midwest/North Central region. Responses for this region are discussed below. Approximately 58 percent of the producers surveyed indicated that income would be lower this year than last year. Approximately 35 percent of the respondents expected to purchase new or used equipment this year and approximately 20 percent expected to expand their land base. Approximately 11 percent of the respondents indicated that they would be hiring fewer employees. Conversely, approximately 8 percent of the respondents indicated that they would be hiring more employees. The biggest challenge identified by producers in the Midwest/North Central region was input costs. More information pertaining to the survey can be found in the summary of the survey posted to my contributor site on Ag Manager under “Recommendations for Further Reading”.

The Bureau of Economic Analysis (BEA) is an agency of the Department of Commerce. In this capacity, the BEA produces economic statistics that allows individuals to follow and understand the performance of the U.S. economy. The web site for the BEA (www.bea.gov) contains a wealth of information pertaining to gross domestic product, balance of payments, GDP by state and metropolitan area, personal income, and GDP by industry.

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The Kansas Farm Management Association (KFMA) Newsletter is distributed monthly to provide farm management information to farm decision makers. Further farm management information can be found on the KFMA program website: www.agmanager.info/kfma; and, on the Extension Agricultural Economics website: www.agmanager.info. The Newsletter is edited by Michael Langemeier, Professor, Department of Agricultural Economics, Kansas State University.



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