

## Are we courting disaster?

by Daryll E. Ray, *Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and director, UT Agricultural Policy Analysis Center, 865-974-7407; dray@utk.edu; http://www.agpolicy.org.*

The 2001 corn stocks-to-use-ratio for the United States is projected to be 0.159, the twelfth lowest in the last forty years (for the world less China it is projected to be 0.129, also the twelfth lowest level). If China is included—China's stock levels are as usual, uncertain and unverified—then the stocks-to-use ratio is 0.206, the fourteenth lowest level in the last forty years.

With stocks at those levels why are prices at record lows? From the U.S. perspective, there are two reasons. The first is that in many of the past years government or Farmer-Owned-Reserve stocks—although isolated from the market for a range of prices—were available and made the stock-to-use ratio larger for a given level of price. The other reason market prices tend to be low even though stocks are low is that the market knows there are no farm program instruments that will kick in now, or next crop year, to raise prices. Market participants would bid up prices if they anticipated additions to government stocks or the Farmer Owned Reserve this year or if acreage reduction programs were likely to be instituted next crop year. Since none of these actions are possible under current legislation, buyers have every reason to believe that prices will be just a low or lower next crop year. And with continued good weather providing trend level or better increases in yield, crop prices will indeed remain low.

But low prices are not the only thing that farmers and the nation have to be on the lookout for. In some ways, we have the worst of all possible worlds. Prices remain low, although stocks are relatively small compared to the past. However, if a yield catastrophe hits, there are no stocks to buffer prices and to provide assurance to exporters and domestic demanders that the U.S. is a dependable supplier of grain. With stocks at the present relatively low levels, what would happen if we had a drop in corn yield similar to the ones we experienced in 1993 or 1988 or 1983? What would happen

to our projected 2001 corn carryover levels of 1.57 billion bushels, if we had two poor crops in a row?

If we had a 23–29 percent drop in yields like we saw in 1983, 1988, and 1993 along with the concomitant increase in the abandonment of planted acres, we could see the current modest carryover levels drop significantly and prices rise to unprecedented levels. It is not inconceivable that producers could see a lot of \$5 corn with peaks as high as \$10. The other crops would be affected as well resulting in some utilization changes being made due to the shortage of “cheap” corn. Again it is not inconceivable that we might see \$10 beans with higher peaks.

While prices like that would be good for those who have something to sell, the repercussions would be dramatic. Some of our steady export customers would have to develop contacts elsewhere in the world. Like Charlie who got on the Kingston's Trio's MTA, one has to wonder “if they would ever return.” Some of our largest hog and poultry conglomerates would likely become significant importers of grain and soybean meal—a practice they might become comfortable with. For those who have both grain and livestock, what they gained in the grain prices would be lost on the livestock side of the operation.

Besides not satisfying the needs of traditional demanders, the high prices would cause countries around the world to further step-up major-crop production. It is one thing to talk about raising loan rates \$0.20, it is quite another to have \$4, \$5, or \$6 corn. And, we know that when new acreage is brought into production, the increase tends to be relatively permanent.

All of this brings us back to a point we have made before. Properly administered, an emergency food reserve could be of vital importance to producers and consumers in the US and around the world. While short-term high prices might feel good, everyone may benefit more in the long run with a more stable food supply system that can accommodate significant weather-related production problems.



## Handling gains and losses on cooperative stock \*

by Neil E. Harl, *Charles F. Curtiss Professor in Agriculture, professor of economics, 515-294-6354, harl@iastate.edu*

The reporting of gains and losses on the stock of cooperatives has been a pressing issue in many farm communities as value-added cooperatives

\* Reprinted with permission from the January 4, 2002 issues of *Agricultural Law Digest*, agricultural law press publications. Footnotes not included.

continued on page 6

Handling gains and losses on cooperative stock, continued from page 5

and other cooperatives have failed or merged with cancellation of patronage equities. In many instances, the question is the proper characterization of the equity interest relinquished by the patron and whether losses are ordinary losses or capital losses.

Rev. Rul. 70-64

A 1970 revenue ruling, Rev. Rul. 70-64, has provided helpful guidance for situations similar factually to the facts in the ruling. In that ruling, a taxpayer operating a chicken farm became a member of an agricultural cooperative for purposes of acquiring supplies and marketing eggs and chickens. The cooperative followed the practice of retaining patronage dividends to augment capital with qualified written notices of allocation. The cooperative normally redeemed the qualified notices of allocation, usually within one to two years. In the year in question, the cooperative redeemed the qualified written notices of allocation but at less than their stated amount on issuance. Thus, the taxpayer incurred a loss when the allocation was redeemed. The question was the nature of the loss—whether an ordinary loss or a capital loss.

The ruling states that—

“...the taxpayer joined the cooperative to facilitate his business and to make it more profitable. The transaction that gave rise to the issuance of the notice of allocation arose in the ordinary course of taxpayer’s trade or business. Accordingly, the loss incurred by the taxpayer upon redemption of the qualified written notice of allocation is an ordinary loss deductible...under the provisions of section 165 of the Code.”

The loss was measured by the difference between the stated amount included in income in the earlier year and the amount received upon redemption.

It is noted that the loss did not involve an equity investment by the patron in the cooperative; rather, the loss involved the failure to receive the benefit of amounts reported into income in the earlier year.

Investment in cooperatives

The more difficult question is the proper treatment of gains and losses for equity interests in a cooperative which were purchased or otherwise acquired in a transaction that did not involve allocated patronage earnings.

It is important to note that all assets are considered to be capital assets other than for specified exceptions. The exceptions are for:

- 1. inventory property,
2. property held by the taxpayer primarily for sale to customers in the ordinary course of a trade or business,
3. depreciable property used in the trade or business,
4. real property used in the trade or business,
5. copyrights and compositions, and
6. U.S. Government publications.

Stock in a cooperative does not seem to fall within any of the exceptions. [Cf. Peake v. Comm’r, 10 TCM 577 (1951) (taxpayer’s interest in a cooperative apartment venture consisted of stock in a cooperative apartment corporation rather than of a proprietary lease and deduction for loss in year investment became worthless was long-term capital loss).] Therefore, it would appear that an investment in stock of a cooperative, including a value-added cooperative, would be a capital asset with a loss properly characterized as a capital loss.

Cooperative part of “trade or business”?

A further question is whether an equity interest in a cooperative could be classified as a “Section 1231 asset” which would permit net losses to be treated as ordinary losses. Some have argued that, since membership in some cooperatives requires members to be producing a particular product (e.g., corn or sugar beets), membership in the cooperative could be deemed a part of the trade or business.

The problem with that argument is that the definition of “property used in the trade or business” for purposes of Section 1231 capital gain (or ordinary loss) treatment is relatively narrow—

“The term ‘property used in the trade or business’ means property used in the trade or business, of a character which is subject to the allowance of depreciation provided in section 167, held for more than 1 year, and real property used in the trade or business, held for more than 1 year....”

Obviously, cooperative stock or other equity instruments in a cooperative are neither depreciable property nor real property used in the trade or business.

In conclusion

Losses attributable to allocated patronage, which has been reported into income appear to be deductible as ordinary trade or business losses. However, losses from investments in cooperative equities would seem to be properly characterized as capital losses.

... and justice for all

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA,

Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964. Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Stanley R. Johnson, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.

Permission to copy

Permission is given to reprint ISU Extension materials contained in this publication via copy machine or other copy technology, so long as the source (Ag Decision Maker Iowa State University Extension ) is clearly identifiable and the appropriate author is properly credited.