



Resources Available to Farmers Struggling with Farm Financial Stress

Farmers have been facing many financial stress issues related to commodity prices and the overall farm economy. The University of Kentucky Department of Agricultural Economics recognizes these challenges and wants to connect producers, as well as agents, lenders and others who support the industry, to resources that may be useful as they work through their current situation and/or potentially consider changes to their operation. The following is compiled by the Agricultural Economics Extension Committee.

1) Understanding financial statements and key financial performance measures

Financial statements are important to assess the financial health of a farm. Two key statements that are used for financial management are balance sheets and income statements. Both are discussed below to help farms measure, evaluate, control and improve financial health.

Balance Sheets

Balance sheets are a systematic listing of all the farm's assets (what it owns), liabilities (what it owes) and equity (the difference between assets and liabilities) taken at a single point in time (e.g. Dec. 31, 2018). Both assets and liabilities are classified as current or noncurrent (also used is current, intermediate and fixed assets or liabilities). Balance sheets show if a farm is solvent and liquid (discussed in detail below under financial performance measures) but do not reflect profitability. More information regarding the basics of a farm balance sheet can be found here: <https://ohioline.osu.edu/factsheet/anr-64>.

Also, sample balance sheets can be found at the links below:

<http://agmanager.info/farm-management-guides-0/balance-sheet-financial-management-tool> and http://agecon.okstate.edu/farmbook/files/Farm_Balance_Sheet.pdf.

Note: Balance sheets are also called net worth statements, statements of financial condition or statements of financial position.

Income Statements

Income statements summarize revenue and expenditures over a period of time. It is typical to use a calendar year (Jan. 1 – Dec. 31, 2018) for income statements. The major categories in an income statement include: gross revenue, value of farm production, cash operating expenses, expense inventory adjustment, depreciation, interest expense and net farm income. Income statements measure the success of a business by determining how profitable the farm was during a period of time. They answer the question, how much money did the farm earn last year? More information on income statements can be found here: <https://www.extension.iastate.edu/agdm/wholefarm/html/c3-25.html>.

Note: Income statements are also called profit and loss (P&L) statements or operating statements.

Financial Performance Measures

Financial performance measures are critical to understanding the financial health of a farm business. The need to measure financial performance has increased since producers rely more and more on borrowed capital. Lenders require these performance measures to assess the financial risk of a farmer repaying a loan in a timely manner. These measures use information from both the balance sheet and income statements to calculate ratios that are grouped into five categories: profitability, liquidity, solvency, financial efficiency and repayment capacity. Most producers understand the concept of profitability, but the other categories are not as straight forward. Liquidity is the business's ability to meet its financial obligations on time. Solvency is the ability to pay all debts if the farm was sold tomorrow. Solvency is important in evaluating the financial risk and borrowing capacity of the business. Financial efficiency measures how effectively the business uses assets to generate income. Finally, repayment capacity is a measure of how much money is available to pay debt on time. More information, calculations and benchmarking of financial performance measures can be found here:

<https://www.cffm.umn.edu/Publications/pubs/FarmMgtTopics/FarmFinanceScorecard.pdf>.

Kentucky Farm Business Management Program

The Kentucky Farm Business Management program provides farmers with training, counsel and documentation for record-keeping, taxes, farm loans, decision-making and business management. Aggregate data from cooperating farmers is used to provide comparative analysis of similar types of operations, enterprises and financial condition.

<http://www.uky.edu/Ag/KFBM/>

2) Understanding FSA loan programs and how they might be helpful

The U. S. Department of Agriculture Farm Service Agency offers a wide-range of loan programs to farmers. Farmers currently suffering financial stress should be especially familiar with three farm loan programs offered by the FSA: Guaranteed Loan Program, Farm Operating Loans and Emergency Loans. Each of these programs are discussed below and a full list of Farm Loan Programs can be found at: <https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/index>.

Guaranteed Loan Program

USDA-FSA offers 90% (and possibly up to 95%) guarantees on loans through agricultural lenders. These guarantees are available on farm purchases, construction of fixtures, etc., but are also available on operating loans, which may be especially helpful for farmers who are working with their existing lenders and struggling to obtain financing. Under some conditions, these guarantees could be used for refinancing existing debt. The guarantee effectively lowers the risk level to the lender and allows them to make loans that they might not otherwise be able to make. If producers are interested in this program, they should start with their agricultural lender, and the lender can investigate/arrange for the guarantee. It may be also be beneficial for producers to visit their local farm loan team at the FSA office to discuss options. The lender is typically charged a 1.5% fee for the guarantee, which is

likely passed on to the borrower. Further information about the Guaranteed Loan Program is available at: <https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/guaranteed-farm-loans/index>.

Farm Operating Loans

In addition to loan guarantees, the FSA offers direct farm operating loans for producers unable to obtain reasonable credit elsewhere. These loans can be used for a wide range of needs such as farm restructuring, livestock, equipment, repairs and operating expenses. Under the new Farm Bill, operating loans (annual operating loans and/or chattel loans) can be made for up to \$400,000. The longer term for chattel loans (7 years) and lower interest rate can be beneficial in helping farming operations maximize cash flow during this strained ag economy. In some circumstances the loans could be used to refinance existing debt and/or term out stale debt on operating lines. Producers interested in farm operating loans should make contact with their local Farm Loan Program Service Center. Further information is available at: <https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/farm-operating-loans/index>.

Emergency Loans

Emergency loans are available to farmers in counties falling under disaster declaration, who have suffered more than a 30% loss, and are unable to obtain credit elsewhere. A significant number of Kentucky counties are currently under disaster declaration as a result of weather challenges this winter. The use of emergency loans is pretty flexible and potentially includes replacement of property, production costs, refinancing of existing debt and even living expenses. Producers who feel they may be eligible and interested in emergency loans should reach out to their FSA Farm Loan Service Center. Further information about emergency loans can be found at: https://www.fsa.usda.gov/Assets/USDA-FSA-Public/usdfiles/FactSheets/2017/emergency_loan_program_oct2017.pdf.

Phone numbers for FSA's Farm Loan Program Service Centers:

Bowling Green: 270-843-1111	Mt. Sterling: 859-498-5487
Columbia: 270-384-6431	Owensboro: 270-6849286
Cynthiana: 270-384-6431	Russellville: 270-726-3006
Flemingsburg: 606-845-4841	Shelbyville: 502-633-3294
Hardinsburg: 270-756-5263	Somerset: 606-678-4842
Hopkinsville: 270-885-5066	Springfield: 859-336-7775
Mayfield: 270-274-9525	Stanford: 606-365-3103
Monticello: 606-348-9383	West Liberty: 606-743-3410

3) Understanding the tax implications from discontinuing a farming operation

Liquid Assets – The case of income without expenses

While many things are to be considered when making the decision to quit or retire from farming, tax consequences can be significant and are often overlooked. Typically, the most

liquid of assets will be the first to go. Liquid assets are those that would be converted to cash in the normal business operating year. For many farmers, this will be grain in storage, hay or market livestock. Many ongoing farm operations will have inventory held over from one year to the next. This may be because of marketing purposes or income tax management reasons (assuming a cash basis taxpayer). In an ongoing operation, the income from these sales would be at least partly offset by expenses in the current production year or prepaid expenses for the following year. When a farmer decides to stop farming, it may be that there is income recognized for tax purposes in the year they quit with little to no expenses to help offset net income. This can result in a significantly higher tax liability compared to previous years. Planning in advance to stop farming for a future year can allow for better management of income and prevent this “bunching” effect.

Equipment and Other Depreciable Assets – Ordinary Gains

Choosing to sell equipment and other depreciable assets (i.e. purchased breeding livestock) also have tax consequences. When selling a depreciable asset, you have to recognize the gain on that asset when it is sold. The IRS defines the gain as the difference between the selling price of the asset less the basis (adjusted basis) in the asset. The basis is essentially the amount of depreciation left on the asset. If the asset is fully depreciated, the gain will be equal to the selling price. Individuals will have to pay income tax on the gain of these sales, but the gain is not subject to self-employment tax. Capital gains do not apply in this scenario. The only time capital gains would apply in a depreciable asset sale is when you sell an asset for more than the purchase price. Then the capital gain portion would only apply to the portion of the proceeds that exceeded the purchase price and ordinary gains would apply to the remainder. In most cases when there is a mass sale of equipment (i.e. auction), large taxable gains are recognized. One possible solution is a piecemeal approach to selling equipment to spread the gains over more years.

Raised Breeding Livestock

Raised breeding livestock may be taxed at the capital gains tax rate assuming the animal is raised and has been held for 24 months for cattle and horses or 12 months for other species. Typically, the basis in these animals is zero as the costs of raising these animals were deducted over time as ordinary expenses.

Selling Land

Typically, selling land will result in a capital gains situation. This is working under the assumption that the land has been held for 12 months or more and is sold for more than when the land was originally purchased. Capital gains rates are preferred to ordinary income tax rates as they are typically lower. However, farmers who sell land, typically fall into the highest capital gains tax bracket because all of gain is realized in one year and the gains are typically significant. An installment sale is one potential option to help lower the tax rate and realize the gain of a land sell over a period of years.

Conclusion

A strategic tax management plan is critical when deciding to exit farming. It is advisable to seek a qualified tax professional to help determine the best plan before selling assets. Other strategic options include farm income tax averaging to help manage tax liabilities. Leasing the farm is another option but has its own tax considerations. To read more about the tax implications of discontinuing a farm operation, see the links below:

www.ruraltax.org

<https://www.extension.iastate.edu/agdm/wholefarm/pdf/c4-83.pdf>

<https://www.cffm.umn.edu/publications/pubs/farmmgttopics/transferringthefarmseries.pdf>

4) Understanding bankruptcy and debt reorganization

Nobody's long-term business goals include bankruptcy. It is an action of last resort, and one that carries a lot of misconceptions, fears, confusion, stigmas and is rife with emotions. Possibly one of the biggest misconceptions about bankruptcy is that it is the ultimate death blow to a business. This is not always the case. There are two different bankruptcy strategies; liquidation and reorganization. Six different bankruptcy chapters exist in the U. S. covering these two strategies. Chapter 7 is sometimes referred to as liquidation. Chapters 11 and 13 are reorganization bankruptcies that allow for debtors to come up with repayment plans to pay back some or all of their debt over a period of time and may allow for restructuring debt. Chapter 9 is reserved for municipalities, and Chapter 15 was created in 2005 to handle bankruptcy cases that involve more than one country. Chapter 12 is a reorganization bankruptcy developed for farmers and fishermen that allows the debtor to continue to operate their business if certain criteria are met.

Chapter 12 Bankruptcy Code was added to existing bankruptcy chapters in the 1980s and allows family farmers and family fisherman to propose a plan to the courts to restructure their debt with a repayment plan. The repayment plan is structured over a 3- to 5-year period, but generally cannot exceed 5 years. It is an action that must be initiated by the debtor by petitioning the court. Chapter 12 Bankruptcy Code dictates that the debtor must submit a repayment schedule to the court within 90 days of filing the petition. During the duration of the bankruptcy and after, the farmer may continue to farm, and in most cases, the farm assets remain in the debtor's possession.

The terms family farmers and family fisherman cover an individual or an individual and their spouse, but do not exclude partnerships and corporations from using this form of bankruptcy. In order for corporations and partnerships to qualify for Chapter 12 bankruptcy, the corporation or partnership must be at least 50% owned by an individual or an individual family. Also, the farming activities within the partnership or corporation must be carried out by the individual, family or relatives. Those filing Chapter 12 as an individual or an individual and spouse must meet four criteria:

1. Total debt cannot exceed \$4,153,150 for farmers or \$1,924,550 for fishermen. Both debt limits are adjusted for inflation every 3 years.

2. Must be engaged in farming or commercial fishing.
3. At least 50% of a farmer's or 80% of a fisherman's total debt must come as a result of farming/commercial fishing.
4. More than 50% of the gross income for the preceding year must have come from farming/commercial fishing. For farmers, if the previous year failed this income test, then the previous two years before the most recent year must have resulted in more than 50% of gross income derived from farming.

In addition to these four criteria for individuals and spouses and the 50% ownership rule mentioned above, corporations and partnerships must meet additional criteria. Specifically, assets of the corporation or partnership must be related to farming/fishing by more than 80%. Further, for corporations that issue stock, stocks cannot be publicly traded.

When the petition is filed with the court, other documents are also required to be filed. These documents contain information such as a listing of all debts and assets, as well as evidence of farming income, farm expenses and living expenses. Further, the court appoints a trustee who receives payments from the debtor, and the trustee pays the creditors. Within 21 to 35 days of filing the petition the trustee will hold a meeting with the creditors. In this meeting, the debtor is placed under oath, and the trustee and creditors ask questions about the debtor's financial situation and proposed repayment plan. This is followed up by a confirmation hearing within 45 days of filing the repayment plan. Here the judge determines if the plan is achievable and if it meets the requirements for Chapter 12 bankruptcy. If so, the plan is confirmed.

When fulfilling a confirmed repayment plan, the debtor gives the trustee all of their disposable income. Disposable income is generally defined for these purposes as what remains from gross revenue generated by the farm/fishing business after subtracting business expenses and family living expenses. The trustee retains a fee for handling the funds and then pays the remainder to the creditors. Ultimately, in Chapter 12 bankruptcy, it has to be shown that creditors will receive as much repayment under this chapter as if the farmer/fisherman had filed Chapter 7 bankruptcy (total liquidation). If this requirement is satisfied, and the farmer/fisherman is able to meet the repayment plan schedule, remaining unsecured debt is discharged at the end of the repayment plan. This does not mean that all unsecured debt will be repaid in total. As long as the debtor makes all payments in the confirmed plan, and all disposable income is given to the trustee, unsecured debt is discharged at the end of the bankruptcy. Failure to fulfill the repayment plan can result in the case being dismissed (no debt discharged) or allow for the case to be converted to Chapter 7 bankruptcy.

One advantage of Chapter 12 bankruptcy allows for secured debt to be written down to the actual asset value with the difference being treated as unsecured debt. For example, assume a farmer owes \$50,000 on a tractor but the tractor is only worth \$35,000. As a result, the secured debt can be written down to \$35,000 for the tractor and \$15,000 of the previous debt will be treated as unsecured debt.

Generally, debt cancellations (discharges of debt) that result from bankruptcy are considered taxable income. However, the amount of debt cancellation can be excluded from taxable income by reducing tax attributes for the tax year in which the debt cancellation was received. The IRS provides an order for which tax attribute reduction must occur and it follows:

- Net operating losses (for any NOL created in the current year and any NOL carried forward to the current tax year)
- General business credit carryovers
- Minimum tax credits
- Capital losses
- Basis (both depreciable and non-depreciable property)
- Passive activity loss and credit carryovers
- Foreign tax credits

Tax attributes are reduced dollar for dollar except for credit carryovers. Credit carryovers are reduced \$0.333 for each dollar reduction of debt cancellation excluded from taxable income. Tax attributes are reduced until the reduction equals the debt discharged or all tax attributes are reduced. It is important to note that the debtor may first choose to absorb some, or all, of the debt discharged as a reduction of asset basis before applying any remainder to the list of other tax attributes.

The option to exclude debt cancellation from taxable income by reduction of tax attributes does not entirely forgive the tax that would be due from the discharged debt if it were added to taxable income. Instead, reduction of tax attributes is a postponement of tax liability. With that concept in mind, it is important to strategically determine what tax attributes to “use up.” For example, if farmland is likely not going to be sold in the debtor’s lifetime, instead being passed on to the debtor’s heirs upon death, reduction of basis in the land may be more beneficial for the debtor by preserving other tax attributes if they exist. In this case, the land basis could be used to absorb some or all of the debt cancellation excluded from taxable income and the heirs will receive a “stepped-up” basis when the land is inherited.

Clearly, Chapter 12 bankruptcy is an extremely complex legal action that requires competent legal counsel, and this discussion only provides a brief overview of a chapter of bankruptcy that is available for qualifying farmers and fishermen. It is intended only to be educational in nature. If your farming operation is financially stressed, it is advised that you reach out to farm financial experts to weigh your options.

5) Transitioning to something else/potential for off-farm employment

One of the best things about farms is that they are family businesses. One of the worst things about farms is that they are family businesses. This is not a revelation to anyone in a farm family. Generally, the benefits of working with family, raising kids on the farm, and learning

and teaching across generations outweigh the disadvantages of putting up with family every day.

In many multigenerational farms the notion of heritage is a strong and positive motivator. Producers often proud of being fifth-generation farmers. It can be, however, a millstone around the neck. When family members want to work together and get along well, it's one of the most beautiful things in the world. When things don't go well, it can be one of the most miserable places to work and live and a harder place to leave.

Financial stress associated with low prices and reduced profits (or losses) can conspire to make a tolerable situation worse. And, when tough business decisions run head-on into family dynamics, the sparks can fly. As family farms face tougher times, communication and transparency on the business side are more critical than ever. Ignoring or delaying tough decisions doesn't make them go away.

While few pasture pundits see this farm financial downturn being as catastrophic as the 80s, it is inevitable that some farms will financially fail. Some will be restructured. Some families will part ways. One of the perils of being one of those pundits for a few decades now is observing that many of these "failures" could have been averted with earlier action.

One of those actions could have been letting go or doing something else. If an accountant decides to become a school teacher, it's a career change. If a teacher decides to become a forest ranger, it's a career change. But, if a farmer decides to do anything else, it's a failure—even if it's a perfectly good career move. It is time to allow voluntary exit from farming without the family and community stigma of "failure." Sometimes it's ok to do something else.

A 2013 USDA study found that 91% of farm households have at least one family member working an off-farm job. Even households operating large farms often have substantial nonfarm income. The study described the farm operators' off-farm occupations. About one-third worked in a management and professional position, 26% in services, 20% in production and transportation, 16% in construction and maintenance, and 6% in sales and office support positions. Kentucky has invested in a robust career network, designed to assist individuals to identify occupations they would be most qualified for.

Phone Numbers for Kentucky Career Center Hubs:

Bowling Green: 270-746-7425

Covington: 859-292-6666

Elizabethtown: 270-766-5115

Hazard: 606-436-3161

Hopkinsville: 270-889-6509

Lexington: 859-233-5940

Louisville: 502-595-4003

Morehead: 606-783-8525

Owensboro: 270-686-2502

Paducah: 270-575-7000

Prestonsburg: 606-889-1772

Somerset: 606-677-4124

Satellite offices located in almost every county: <https://kcc.ky.gov/Pages/Locations.aspx>

6) Resources related to managing farm stress and mental health

Farm Dinner Theatre

Farm Dinner Theatre was developed to create an environment where producers can discuss sensitive topics through humorous stories. A local extension agent builds a planning group of farmers that choose key issues relevant to the location. These issues are then used to script short plays using local farmers as actors. Each play is followed with a discussion of the story, led by a nurse facilitator. More information on Farm Dinner Theatre can be found at <http://www.aannet.org/initiatives/edge-runners/profiles/edge-runners--farm-dinner-theatre>, or by calling your local extension office: <http://directory.ca.uky.edu/view-by-county>.

Mental Health First Aid

Mental Health First Aid is an 8-hour training that covers signs and symptoms of mental illness and substance abuse, how to interact with someone dealing with those issues, how to access their risk of suicide, and how to encourage them to get professional help. The UK College of Agriculture, Food and Environment will be hosting an on-campus train-the-trainer for Mental Health First Aid Certification. These certified trainers will then be able to serve as instructors in the state. <https://www.mentalhealthfirstaid.org/>

AgrAbility Mental/Behavioral Health Issues

The AgrAbility Mental/Behavioral Health Issues page has a significant number of resources related to mental health including helplines, links to videos and webinars that producers can watch on their own, links to organizations that offer resources, as well as information on stress management, substance abuse and suicide prevention. See their site at: <http://www.agrability.org/resources/mental-behavioral-health/>.

Michigan State University: Managing Farm Stress

Michigan State University Extension provides resources that supplement their train-the-trainer education programs. Resource material provides tips to help manage anger and how to relax in a stressful environment. The news section provides short articles explaining techniques that can be used to reduce stress, how to address conflict within the farm family, how to maintain a positive outlook amidst stress and other mental health issues. Michigan State University provides an online program for non-university staff or students. https://www.canr.msu.edu/managing_farm_stress/

Surviving the Farm Economy Downturn – Chapter 20: Preventing Farm-related Stress, Depression, Substance Abuse, and Suicide

The Southern Extension Economics Committee’s regional publication, “Surviving the Farm Economy Downturn,” is an excellent resource that discusses a wide range of management topics for row crops, livestock and specialty crops. Chapter 20 specifically discusses the impact of financial stress on the farmer and farm family. This chapter will help farmers and those that work with farmers to identify signs that someone may be in risk of depression, abusing drugs or alcohol or thinking about self-harm. This chapter is written as an introduction to the topic using common language.

<http://www.afpc.tamu.edu/extension/resources/downturn-book/>

The AgriSafe Network: Mental and Behavioral Health Website

The AgriSafe Network is a complete resource to help farm families with personal and farm safety issues. The website has a section on mental and behavioral health to help identify factors indicating stress, mental health issues and suicide prevention resources.

<https://www.agrisafe.org/mental-and-behavioral-health>

Joe Schroeder at Farm Aid

Many of these resources highlight the importance of talking to someone if suffering stress and if considering self-harm. One-on-one conversations may be helpful, and the Farm Aid organization is a resource to help farm families have this conversation. Farm Aid works with organizations around the country staffed with farm advocates, counselors and hotline operators that can help. The Farm Aid hotline is **1-800-FARM-AID** but is staffed Monday to Friday from 9:00 am to 5:00 pm Eastern. Joe Schroeder is a good resource for personal communication about farm stress issues. Schroeder coordinates the Farm Advocate network to help support the effort to help farmers.

<https://www.farmaid.org/author/joeschroeder/>

Contributors: Jonathan Shepherd, Jordan Shockley, Todd Davis, Greg Halich, Alison Davis, Steve Isaacs, Jerry Pierce, Sarah Bowker and Kenny Burdine.

Educational programs of Kentucky Cooperative Extension serve all people regardless of economic or social status and will not discriminate on the basis of race, color, ethnic origin, national origin, creed, religion, political belief, sex, sexual orientation, gender identity, gender expression, pregnancy, marital status, genetic information, age, veteran status, or physical or mental disability. UNIVERSITY OF KENTUCKY, KENTUCKY STATE UNIVERSITY, U.S. DEPARTMENT OF AGRICULTURE, AND KENTUCKY COUNTIES, COOPERATING