Taxation and Livestock Production in New Mexico

Circular 635

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This publication is scheduled to be updated and reissued 10/13.

INTRODUCTION

Livestock production in New Mexico is certainly not an easy proposition from either a financial or a production perspective. Many factors, including climatic conditions, price cycles, governmental policy and input costs, produce fluctuations in financial performance annually. The certainty of death and the opportunity to pay taxes are the only two assurances found in ranching today. Progressive tax management can facilitate successful management and reduce the overall stress associated with livestock management. This paper's goal is to provide a basic understanding of the tax liability of a typical ranching unit in New Mexico for the 2006 tax year.

METHODS

This study makes several assumptions about the average tax liability that an operator will incur at the federal, state and local levels. The acreage associated with the ranching unit, how much of that acreage is deeded, carrying capacity, number and class of livestock and purchased inputs are all important parameters, as the tax liability is determined for each level. A comprehensive tax return was completed at the federal and state level in the determination of the tax liability.

This representative ranching unit will be assumed to be a 50% deeded, 50% leased ranch comprising 25,600 total acres, with a carrying capacity of 10 animal units per section yielding 400 animal units yearlong. The animal units for this study will be beef cattle placed in south-central New Mexico. Historical New Mexico Range Livestock Cost and Return Estimates (Hawkes & Libbin) will be employed to develop production costs, including vehicle use, depreciation, feed, trucking, mortgage interest, hired labor, rental rates, repairs, supplies, veterinary care, utilities and taxes paid. Each of these values will be incorporated into a Schedule F, Schedule A, 1040 and Personal Income Tax form required for New Mexico residents representing net ranch profit or loss, thus determining taxable income for the representative ranching unit. Federal taxation guidelines define the forms that are needed to formally file each annual tax return (Internal Revenue Service, 2007)

TAXES

New Mexico producers are required to pay property taxes on residential as well as agricultural lands, income tax (assuming a profit is realized) at both the state and federal level, livestock ownership taxes, self-employment taxes, fuel taxes and state gross receipt taxes on consumptive goods. The aggregate of these taxes can amount to quite an impressive number. Many of these taxes are payable by all taxpayers and are not directed solely at agricultural producers. Table 1 presents the taxes that livestock producers in New Mexico are responsible for at each taxation level.

Table 1. Types of Taxes Payable by a New Mexico Livestock Producer

Taxation Type	Local	State	Federal
Gross receipts	X		
Livestock ownership		X	
Income		X	X
Property	X	X	
Fuel		X	X
Self-employment			X

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LOCAL TAXATION

Taxes that are payable at the local level include gross receipts on consumptive items (excluding groceries), livestock ownership taxes and property taxes on both residential and non-residential properties. A discussion of the methodology of each of these types of taxes may be useful for the reader. Gross receipts taxes are paid on a percentage of the overall cost of the item in question, excluding grocery items. An example of this may be the purchase of clothing. Added to the overall cost of the clothing will be a charge of approximately 7% throughout most municipalities in New Mexico. The gross receipts tax will vary throughout all municipalities in the state. Livestock ownership taxes are paid at the county level and are based on indemnity rates associated with each class of livestock. These values are constant for the state per class of livestock held. The total market value of the livestock is established by a panel annually at the state level; this value is divided by three to determine the taxable value for the current tax year. For example, if a beef cow is valued at $900, her taxable value would be $300 (Taxation and Revenue Department, 2007). Taxes are assessed on property each year with a state mandated cap increase of 3% annually (Taxation and Revenue Department, 2007). All classes of real property are considered, with most producers holding both residential as well as agricultural lands. These classes of property are taxed on the basis of market value, taxable value and a mill levy, which varies at the municipality and county levels. The taxable value for real estate and livestock in New Mexico is equivalent to one-third of the market value the asset holds.

FEDERAL AND STATE TAXATION

There are taxes that accrue at the state and federal levels, examples fuel and income taxes. Fuel such as taxes are a regressive tax, based on a consumptive value—the tax liability per gallon is held constant. The more an individual consumes, the greater their tax expenditure will be at the federal and state levels. Agricultural producers may purchase fuel and have it delivered to their homes. Assuming this fuel is only used in vehicles that will not be on state or federal highway systems, it is tax exempt. The most common example of this would be fuel used to operate a tractor. Income taxes are payable on all profits gained in the operation of a business of any basis and are accumulated on a percentile basis relative to the profit or income level. These are progressive taxes at the federal level, the percentage increases which means as the profit level rises. Seven states do not have a personal income tax assessment, and two additional states only tax dividend and interest income. New Mexico residents, including livestock producers, are subject to personal income taxes.

RESULTS

Two scenarios were analyzed, representing a ranch owner who has a mortgage on the property and a ranch owner who does not have a mortgage. If mortgage interest is paid during the year, the taxable amount of income will vary greatly based on the individual's ability to itemize deductions via a Schedule A. Those taxpayers who complete a Schedule A will reduce their taxable income level at both federal and state levels through the allowable deduction of mortgage interest.

The south-central New Mexico cattle ranch with 400 animal units generated a hypothetical net income of $68,750, assuming the ranch does not have a mortgage associated with it. Assuming a ranch mortgage is in place reduces the projected net income to approximately $9,060. Thus, a mortgage of $59,690 must be retired annually as part of the operating costs for this production unit. Net income was derived by employing market prices received and normal operating costs associated with livestock production in this region as reflected by cost and return estimates. Table 2 reflects the level of taxation that the producer can anticipate with respect to state and federal policies as they currently exist.

As is recognized in Table 2, the aggregate tax liability for the 2006 tax year exceeded $18,000, with a net profit level of just greater than $9,000. Clearly, income taxes do not play a dramatic role in overall taxation in this example, but the combination of property, self-employment and livestock ownership taxes compose 86% of the total tax liability for

Table 2. Taxes Paid by New Mexico Livestock Producers, 2006, With a Mortgage in Place on the Property

Type	State	Federal	Total
Gross receipts	$722		$722
Livestock ownership	$1,185		$1,185
Income	$63	$363	$426
Property	$4,800		$4,800
Fuel	$659	$790	$1,449
Self-employment		$9,714	$9,714
Total			$18,296

Table 3. Taxes Paid by New Mexico Livestock Producers, 2006, Without a Mortgage in Place on the Property

Type	State	Federal	Total
Gross receipts	$722		$722
Livestock ownership	$1,185		$1,185
Income	$3,359	$8,959	$12,318
Property	$4,800		$4,800
Fuel	$659	$790	$1,449
Self-employment		$9,714	$9,714
Total			$30,188

the year. These cash costs have a direct impact on business owners' ability to manage their businesses from both a financial as well as a productive point of view.

Numbers in Table 3 are generated using the same criteria as in Table 2, with the exception that the ranch is currently not mortgaged.

The basic distinction between the two scenarios presented is that as net profit levels increase, income taxation begins to have a greater impact on the overall taxation burden. Income taxes payable at the state and federal levels represent 41% of the tax liability for the tax year in this example. The combination of livestock ownership taxes, property taxes and self-employment taxes makes up 52% of the aggregate tax bill.

CONCLUSION

Taxation is an important part of the United States economy and has an impact on every citizen employed throughout the nation. Income taxes in the United States in 2006 were approximately $6.5 billion (US Census Bureau, 2007). This impact may be felt more intensely by those who own businesses, whether these are agriculture-related or not. The most significant difference that exists between taxation policies toward agribusiness and taxation policies toward other business is the additional levies against livestock ownership and the additional requirement of capital invested in real estate.

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