



# Ag Decision Maker

## A Business Newsletter for Agriculture

Vol. 10, No. 8 [www.extension.iastate.edu/agdm](http://www.extension.iastate.edu/agdm) June 2006



### Accumulator Contracts

by Steven D. Johnson, Ph.D., Farm & Ag Business Management Field Specialist, Iowa State University Extension, (515) 261-4215, [sdjohns@iastate.edu](mailto:sdjohns@iastate.edu)

The Accumulator Contracts were developed by FCStone Trading and first offered for the 2005 crop year. These contracts are typically provided direct by country elevators and hedged through FCStone Trading. The goal is to increase grain origination of large volumes of corn and soybeans with these contracts. Grain merchandisers representing the elevator work with producers interested in committing bushels for delivery. Rapid adoption of these contracts by producers has been witnessed across Iowa as well as select areas of Nebraska and Illinois. The Accumulator Contracts are New Generation Grain Contracts (NGC) that fall in the category of combination that typically use price averaging techniques over a select time period. In addition, price risk is managed by the country elevator

through FCStone Trading. The use of such risk management tools allows Accumulator Contracts to price bushels at futures prices that are typically offered 10 to 20 cents per bushel above the current corn futures price.

The Accumulator Program is facilitated by FCStone Trading directly with a country elevator. A variety of contracts, primarily concentrated on corn, are offered in increments of several thousand bushels to the elevator. The elevator then matches the contracts with various delivery periods to their own specific delivery needs, or a time frame that a producer would like to

*continued on page 2*

### Inside . . .

What's ahead for federal gift tax? ..... Page 4

### Handbook updates

For those of you subscribing to the handbook, the following updates are included.

**Monthly Returns (10 year summary: Swine Farrow to Finish) – B1-31 (2 pages)**

**Monthly Returns (10 year summary: Finishing Feeder Pigs) – B1-34 (1 page)**

**Monthly Returns (10 year summary: Cattle Feeding) – B1-36 (2 pages)**

**Historic County Cropland Rental Rates – C2-11 (5 pages)**

Please add these files to your handbook and remove the out-of-date material.

*continued on page 6*

Accumulator contracts, continued from page 1

deliver the grain. The volume of offerings provides an economic advantage to the elevator as well as convenience for the producer.

**Elevator benefits**

Several benefits are incurred by the country elevator to justify the cost of offering these Accumulator Contracts:

- 1) improved efficiency of grain origination through volume of purchases
- 2) reduced grain handling, transportation costs and timeliness of grain delivery
- 3) tool to target specific farms that have access to on-farm storage and truck transportation.

The merchandisers will likely focus on offering these contracts to customers who understand Accumulator Contracts. In addition, customer prospects with larger volumes of grain, and those who typically deliver directly to processors, terminals or feedlots can be targeted.

**The selling price attraction**

Imagine the producer that is offered \$2.70 or \$2.80 per bushel new crop corn futures price when the current December corn futures contract is trading at \$2.60 per bushel. This selling price above the current futures price, minus basis, is provided by FCStone Trading to the elevator through a contractual arrangement. The basis (cash minus futures) will still need to be established by the producer before these bushels are delivered against the contract.

Thus Accumulator Contracts can possibly be attached to futures only or hedge-to-arrive contracts. Stipulated within the contract are the specifics as to the ability of this contract to be "rolled" to another futures contract for a delivery later than the original delivery period. An additional charge of up to 2 cents per bushel will be paid by the producer upon settlement of the cash sale to the contract.

**Other Accumulator considerations**

The producer that signs up for an Accumulator Contract must first determine the quantity of bushels that they wish to price. Secondly, understand that there will be an accumulation period in

weeks designated for that specific contract with a start date and end date. Each week during this accumulation period, the closing futures price on that specific day of the week will be used to determine how many of the maximum total bushels offered are actually being priced. A typical Accumulator Contract for new crop corn would be offered in early winter with an accumulation period for the first week of April until September, or a 25 week period. If 5,000 bushels are offered as an example, then each week represents 200 bushels to be priced.

Two specific target or index prices will be designated by the contract:

- 1) Accumulator selling price
- 2) Barrier or "knock out" price.

The bushels offered are priced each week during the accumulation period when CBOT futures price, which acts as the index, trades between the Accumulator selling price and the knock out price. An equal number of bushels for that contract will be designated as priced at the selling price quoted.

**Doubling up bushels sold**

However, for this same example the contract will also identify a potential of 10,000 bushels (twice the 5,000 offered) that could be priced. That's because during the accumulation period, for any week with the designated day of the week the actual CBOT close/settlement is above the Accumulator selling price, the number of bushels offered will be doubled at the Accumulator selling price. Thus, should actual CBOT futures prices rally, the producer must understand that they could be committing as many as twice the number of bushels that they thought they offered.

**Knock out price**

Another consideration is the fact that should the designated CBOT futures price trade at or below the knock out price during any week of the accumulation period, the pricing of additional bushels stops permanently and the total bushels priced to that date are then determined. Thus, the risk exists of bushels that the producer offered might not all be priced.

Accumulator contracts, continued from page 2

## 2005 contract performance

Accumulator Contracts Corn: December 2005 Performance	
1. Bushels Priced	5,000 offered– 10,000 potential
2. Accumulation Period	April 1st – Sept. 23rd
3. Accumulator Selling Price	\$2.55/bu.
4. Knock Out Price	\$2.25/bu.
5. Service Charge	Varies by elevator

## December 2005 CBOT Futures

Source: [www.futuressource.com](http://www.futuressource.com)



This Accumulator Contract would have priced a total of 5,200 bushels at \$2.55/bu. The “knock out” price was reached in week 23. However, 2 weeks would have doubled the 200 bushels priced to 400 bushels.

22 weeks X 200 bushels = 4,400 bushels  
2 weeks X 400 bushels = 800 bushels  
 priced and committed delivery = 5,200 bushels

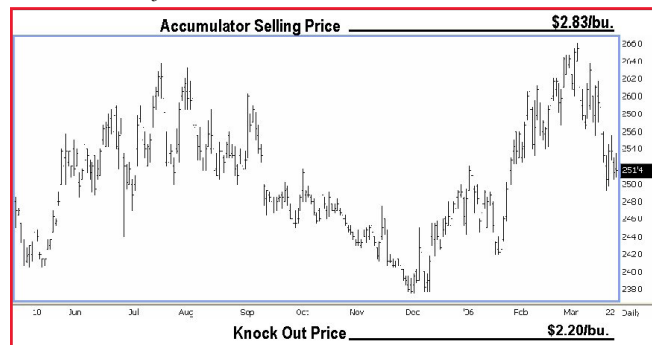
## Example of 2006 contract offered

Several different Accumulator Contracts with a variety of selling prices, knock-out prices and Accumulation periods were available for 2006 corn. An example of one such contract is featured.

Accumulator Contracts Corn: December 2006 Prospectus	
1. Bushels Priced	5,000 offered – 10,000 potential
2. Accumulation Period	April 7th – Sept. 29th
3. Selling Price	\$2.83/bu.
4. Knock Out Price	\$2.20/bu.
5. Service Charge	Varies by elevator

## December 2006 CBOT Futures

Source: [www.futuressource.com](http://www.futuressource.com)



Note that the Accumulation Period for this contract does not begin until April 7th. There is potential for the CBOT December corn futures to be above this \$2.83/bu. selling price. As a result, the number of bushels offered could double. While this could be of concern for some producers, selling more bushels at “high prices” is usually the goal. Caution should be used in understanding the bushels offered versus potential. A producer should never contract more potential bushels to a contract than they are willing to deliver.

## Recommendations

It is critical that producers must understand the pricing mechanisms being provided before signing up for an Accumulator Contract. This consideration includes bushels offered, bushels potential, accumulation period, selling price as well as knock out price and penalties for nonperformance. To assist producers in the use of Accumulator Contracts consider the following:

- 1) for new crop bushels, combine the use of crop insurance revenue tools that guarantee bushels of production and price determined by the higher of spring or fall December corn futures
- 2) the use of a commodity brokerage account for futures and/or options strategies in order to defend the Accumulator selling price
- 3) a basis objective and the use of various strategies to capture a “good basis” on bushels priced and committed to the actual delivery of grain against the contract

Accumulator contracts, continued from page 3

4) and utilize a portfolio approach for preharvest marketing where a variety of marketing tools are featured. No more than 25% of guaranteed crop insurance bushels should be committed to Accumulator Contracts.

Contact your local grain merchandiser regarding the availability of Accumulator Contracts in your area.



### What's ahead for federal gift tax?\*

by Neil E. Harl, Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University, Ames, Iowa. Member of the Iowa Bar, harl@iastate.edu

Since enactment of the repeal legislation in 2001, the focus has been primarily on the federal estate tax and, to a lesser degree, on the generation skipping transfer tax, with relatively less emphasis on the federal gift tax. Yet the federal gift tax may potentially assume much greater importance if the repeal provisions become reality and the transfer tax system does not revert to its 2001 status, as could well occur.

It is important to note that December 31, 2009, is now just over three years away.

#### Review of what was done in 2001

The applicable exclusion amount (which had been expressed as a "unified federal estate and gift tax credit") was amended with the applicable exclusion amount for federal gift tax purposes "decoupled" from the federal estate tax beginning in 2002. For federal gift tax purposes, the applicable exclusion amount was set at \$1,000,000 and remains there indefinitely unless the "sunset" provision goes into effect. At the same time, the federal estate tax applicable exclusion amount was likewise increased to \$1,000,000 in 2002 but, unlike the federal gift tax applicable exclusion amount, was boosted to \$1,500,000 in 2004, \$2,000,000 in 2006 and scheduled for an increase to \$3,500,000 in 2009. Thus, the applicable exclusion amount was "decoupled," but the calculation of the federal estate tax at death remains coupled. The gift tax applicable exclusion amount is the amount in effect under I.R.C. § 2010 but determined as if the

applicable exclusion amount is \$1,000,000.

The top federal estate and gift tax rate (which had been 55 percent for deaths after 1983) (of the excess over \$3,000,000 of taxable estate) was reduced beginning in 2002. The combined rate was reduced to 50 percent for decedents dying and gifts made in 2002, 49 percent in 2003, 48 percent in 2004, 47 percent in 2005, 46 percent in 2006 and 45 percent in 2007 where the rate plateaus until either repeal occurs as to the federal estate tax, the "sunset" provision returns all rates to 2001 levels, additional amending legislation is enacted or, as to the federal gift tax, the rate drops permanently to 35 percent after 2009 (35 percent of the excess over \$500,000). Note that the Congress never anticipated repeal of the federal gift tax and still does not anticipate repeal of the federal gift tax. If the federal estate tax is repealed, the federal gift tax will survive with an applicable exclusion amount of \$1,000,000 and a rate of 35 percent (equal to the maximum federal income tax rate). If the "sunset" provision prevails, both the federal estate tax and the federal gift tax will return to an applicable exclusion amount of \$1,000,000.

Congress was advised in early 2001 that repeal of the federal gift tax would seriously jeopardize the revenue stream from the federal income tax.

\*Reprinted with permission from the April 28, 2006 issue of Agricultural Law Digest, Agricultural Law Press Publications, Eugene, Oregon. Footnotes not included.

What's ahead for federal gift tax?, continued from page 4

Because of Congressional fiscal rules, the 2001 Act provided that Chapter 11 of the Internal Revenue Code (federal estate tax) was not to apply to estates of decedents dying after December 31, 2010. The 2001 Act specified that "all provisions of, and amendments made by the Act shall not apply . . . to estates of decedents dying, gifts made or generation skipping transfers after December 31, 2010." Therefore, all provisions, unless further legislation is enacted amending the provisions, revert to the status of the provisions as of the date of enactment in 2001.

Effect on income tax basis

The provision authorizing a new income tax basis at death, which can be up or down from the decedent's pre-death basis, has generally allowed an income tax basis equal to the fair market value (or value used for federal estate tax purposes) as of the date of death or the alternate valuation date. In a community property state, the surviving spouse's one-half share of community property held by the decedent and surviving spouse generally is treated as having passed from the decedent and thus has been eligible for a new basis at death. The rule applies if at least one-half of the whole of the community interest is included in the decedent's gross estate.

Under the 2001 Act, no change was made in the rules governing income tax basis determinations at death until repeal of the federal estate tax, effective for deaths after December 31, 2009. After 2009, recipients of eligible property transferred at the decedent's death will receive an income tax basis equal to the lesser of the adjusted income tax basis of the decedent or the fair market value of the property at the decedent's death. Property acquired from the decedent will be treated as if acquired by gift except for an additional allowance (which can be used to increase the pre-death basis but not above fair market value) of \$1.3 million per estate, \$3 million in addition for a surviving spouse and \$60,000 for a non-resident who is not a U.S. citizen. The basis increase amounts are adjusted for inflation for decedents dying after 2010, if carryover basis is still in effect at that time. The

\$1.3 million amount is increased by the amount of unused capital losses, net operating losses and certain "built-in" losses of the decedent.

In conclusion

At the moment, the fiscal condition of the country suggests that complete repeal is unlikely with a compromise expected in 2006 or 2007 based upon an applicable exclusion amount of somewhere in the range of \$3 million to \$3.5 million per decedent and a tax rate of 15 percent or higher and a new income tax basis at death.



Updates, continued from page 1

**Internet updates**

The following updates have been added to [www.extension.iastate.edu/agdm](http://www.extension.iastate.edu/agdm).

**Organic Crop Production Enterprise Budgets – A1-18 (7 pages)**

**Using Enterprise Budgets to Make Decisions – A1-19 (7 pages)**

**Dividing Business Income – C1-51 (2 pages)**

**Writing and Designing a Brochure – C5-134 (2 pages)**

**Creating a Display – C5-135 (2 pages)**

**Decision Tools**

**Dividing Business Income** – Use this decision tool to calculate how to divide income between different parties.

**Cash Rental Rate Estimation** – Use this decision tool to compare different methods of computing Cropland Cash Rent.

**Calculating Hay and Pasture Cash Rents** – Use this decision tool to compare different methods of computing rent for hay and pasture ground.

**... 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. Jack M. Payne, 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.