

DEPARTMENT OF TAXATION

2004 Fiscal Impact Statement

1. **Patron** Mark D. Obenshain

3. **Committee** Senate Finance

4. **Title** Agricultural Enterprise Zone Act

2. **Bill Number** SB 482

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would establish a program that would designate Agricultural Enterprise Zones. These zones would be areas within localities that have established as agricultural or forestal districts, or have a purchase of development rights ("PDR") program. The bill would create tax incentives for businesses that establish or expand agricultural or forestal operations. The tax incentives would include:

- The Agricultural Enterprise Zone Business Tax Credit that would allow individuals and corporations an income tax credit equal to 80% of the income tax due to Virginia for the first taxable year and 60% of the income tax due the Commonwealth for the second through tenth taxable years;
- An exemption from the payment of retail sales and use taxes for all items purchased for the conduct of its business located within the agricultural enterprise zone; and
- Local tax incentives, including, but not limited to, reduction of permit fees, reduction of user fees, reduction of the business, professional, and occupational license tax, partial exemption from taxation of substantially rehabilitated real estate, and a local agricultural enterprise zone development taxation program.

The total amount of Agricultural Enterprise Zone Business Tax Credits that could be granted to qualified farm businesses for each fiscal year could not exceed \$5 million. The Department of Agriculture and Consumer Services would be responsible for administering the Agricultural Enterprise Zone program.

The effective date of this bill is not specified.

6. Fiscal Impact Estimates are: Not Available. (See Line 8.)

6a. Expenditure Impact: Department of Taxation

| <i>Fiscal Year</i> | <i>Dollars</i> | <i>Positions</i> | <i>Fund</i> |
|---------------------------|-----------------------|-------------------------|--------------------|
| 2003-04 | \$0 | | GF |
| 2004-05 | \$268,050 | 1 | GF |
| 2005-06 | \$45,010 | 1 | GF |
| 2006-07 | \$46,311 | 1 | GF |
| 2007-08 | \$47,720 | 1 | GF |
| 2008-09 | \$49,139 | 1 | GF |
| 2009-10 | \$50,567 | 1 | GF |

Expenditure Impact: Department of Agriculture and Consumer Services

| <i>Fiscal Year</i> | <i>Dollars</i> | <i>Positions</i> | <i>Fund</i> |
|---------------------------|-----------------------|-------------------------|--------------------|
| 2003-04 | \$0 | | GF |
| 2004-05 | \$85,000 | 1 | GF |
| 2005-06 | \$170,000 | 2 | GF |
| 2006-07 | \$170,000 | 2 | GF |
| 2007-08 | \$170,000 | 2 | GF |
| 2008-09 | \$170,000 | 2 | GF |
| 2009-10 | \$170,000 | 2 | GF |

7. Budget amendment necessary: Yes.

ITEM(S): 97, Department of Agriculture and Consumer Services
284 and 286, Department of Taxation

8. Fiscal implications:

Administrative Costs

The Department of Agriculture and Consumer Services would incur costs of \$85,000 for one full time position in Fiscal Year 2005 to develop and implement the program. For Fiscal Year 2006 and thereafter, an additional full time position would be needed to help administer the program resulting in costs of \$170,000.

In addition, the Department would incur costs of \$268,050 in Fiscal Year 2005 for design, develop, and implement additional systems to administer the credit and one full time position to establish a compliance program. Continuing costs for systems maintenance, compliance, and forms revisions would be \$45,010 in Fiscal Year 2006, \$46,311 in Fiscal Year 2007, \$47,720 in Fiscal Year 2008, \$49,139 in Fiscal Year 2009, and \$50,567 in Fiscal Year 2010.

Revenue Impact

This bill would limit the amount of Agricultural Enterprise Zone Business Tax Credits that can be approved for a fiscal year to \$5 million and provide for the allocation of the income tax credits among taxpayers should requests exceed the annual limitation. Assuming the suggested amendment specifying an effective date of taxable years beginning on or after January 1, 2005, is adopted, taxpayers seeking the income tax credit under the provisions

of this bill would first do so in early 2006. Although information on which to estimate the revenue impact of this credit is not available, the Department of Agriculture and Consumer Services anticipates that applications for the credit would not meet the \$5 million cap in early years of the program.

This bill would also expand the existing agricultural retail sales and use tax exemption for farm businesses located within an Agricultural Enterprise Zone. Because information is currently not available on which to estimate the revenue impact of this exemption, the revenue impact of this exemption on the General Fund, the Transportation Trust Fund, and local revenue is unknown.

9. Specific agency or political subdivisions affected:

Department of Agriculture and Consumer Services
Department of Taxation
Local Governments

10. Technical amendment necessary: Yes.

In order to clarify that an agricultural or farm must be qualified in order to earn the income tax credit proposed by this bill, the following technical amendments are suggested:

Page 3, Line 141, after: from a
Insert: qualified

Page 3, Line 142, at the beginning of the line
Strike: an
Insert: a qualified

In order to make all taxpayers eligible for the Agricultural Enterprise Zone Business Tax Credit for the same taxable years, the following technical amendment is suggested:

Page 3, Line 150, after: C.
Strike: Qualified
Insert: For taxable years beginning on or after January 1, 2005, qualified

In order to conform claims for the tax credits in this bill to the taxable year of a taxpayer claiming the credits, the following technical amendments are suggested:

Page 3, Line 151, after: for the first
Strike: tax
Insert: taxable

Page 3, Line 152, after: for the second
Strike: tax
Insert: taxable

Page 3, Line 152, after: the tenth

Strike: tax

Insert: taxable

Page 3, Line 155, after: future

Strike: tax

Insert: taxable

11. Other comments:

This bill would allow the Governor to designate Agricultural Enterprise Zones within a locality for the purpose of encouraging economic development and job creation in rural areas through state and local tax incentives. The Department of Agriculture and Consumer Services would administer the program. The bill provides no limits on the number of Agricultural Enterprise Zones that may be designated.

In order to be designated as an Agricultural Enterprise Zone, an area must be in a locality that has an agricultural or forestal district or has a PDR program. Local governments would apply to the Department of Agriculture and Consumer Services in order to have an area designated as an Agricultural Enterprise Zone for a period of time specified in the designation application. The application would include a description of the location of the district or area for the proposed Agricultural Enterprise Zone, and a general statement identifying proposed local incentives. The bill provides no maximum limit on the period of time for which an area could be designated as an Agricultural Enterprise Zone.

According to the Department of Agriculture and Consumer Services, 28 counties have an agricultural and forestal district or have a PDR program. The availability of tax incentives provided under this bill would likely cause the number of localities having agricultural and forestal districts and purchase of development rights programs to grow.

Eligible Businesses

Taxpayers could qualify for Agricultural Enterprise Zone incentives as either a “qualified agricultural business” or a “qualified farm business.”

In order to eligible as a “qualified agricultural business”, an agricultural business could establish new agricultural or forestal operations, make a net investment of at least \$250,000, and create at least 3 new full-time jobs within an Agricultural Enterprise Zone. If the business, however, existed prior to the designation of the Agricultural Enterprise Zone, it would qualify for the program incentives by increasing the number of full-time employees by at least 10% over the preceding 2 years.

A “qualified farm business” would be a farm business that establishes new agricultural or forestall operations with a zone and make a net investment of at least \$50,000 or was actively engaged in the conduct of agricultural or forestal production in a zone prior to the area being designated as an Agricultural Enterprise Zone.

General Business Tax Credit

This bill would create an individual or corporate income tax credit for both qualified agricultural businesses and qualified farm businesses. The amount of the credit would be equal to 80% of the Virginia income tax attributable to the Agricultural Enterprise Zone for the first taxable year and 60% of the Virginia income tax attributable to the zone for the second through tenth taxable years. An approved tax credit not used in the taxable year it was earned could not be carried forward.

The amount of any credit earned by a partnership, limited liability company or S corporation would be allocated to the partners, members, or shareholders, respectively, in proportion to the amount of income received from such business entities.

The Department of Agriculture and Consumer Services would be required to certify annually to the Department of Taxation the amount of the general business tax credit for a qualified agricultural or farm business. Any certification made by the Department of Agriculture and Consumer Services would not impair the authority of the Department of Taxation to deny, in whole or in part, any claimed general business tax credit if the Department of Taxation determines that the qualified agricultural or farm business is not entitled to such tax credit.

Under the bill, the total amount of general business tax credits granted to qualified agricultural or farm businesses for each fiscal year could not exceed \$5 million. If the total amount of general business tax credits for which qualified agricultural or farm businesses are eligible exceeds \$5 million in any fiscal year, then the amount of general business tax credit available would be allocated on a pro rata basis among qualified agricultural or farm businesses.

Sales Tax Exemption

Qualified agricultural or farm businesses would be entitled to an exemption from the Virginia retail sales and use tax for all items purchased for the conduct of its business located within the Agricultural Enterprise Zone for a period not to exceed 5 years. The Department of Agriculture and Consumer Services would be required to certify annually to the Department that a qualified agricultural or farm business is exempt.

Currently, Virginia provides an exemption from the retail sales and use tax for commercial feeds, seed, plants, fertilizers, liming materials, breeding and other livestock, semen, breeding fees, baby chicks, turkey poults, agricultural chemicals, fuel for drying or curing crops, baler twine, containers for fruits or vegetables, farm machinery and agricultural supplies sold to farmers for use in agricultural production for market. If, however, the items purchased are used in both exempt and nonexempt activities, only a partial exemption is allowed.

In addition, the retail sales and use tax does not apply to machinery and tools including repair parts or replacements of such machinery and tools, fuel, power, energy or supplies, used directly in the harvesting of forest products for sale or for use as a component part of another product. The term "used directly" means only those activities that are an integral

part of the actual harvesting of the forest product including the cutting down of the product.

The retail sales and use tax exemption proposed in this bill would be broader than exemptions currently permitted under Virginia law. The exemption proposed by this bill would include items used in the farm business (e.g. office equipment) that would not necessarily be used in agricultural production for market or harvesting forest products.

Local Incentives

In making an application for designation as an Agricultural Enterprise Zone, a locality would be authorized to grant local tax incentives, including, but not limited to:

- reduction of permit fees;
- reduction of user fees;
- reduction of the business, professional, and occupational license tax;
- partial exemption from taxation of substantially rehabilitated real estate; and
- adoption of a local Agricultural Enterprise Zone development taxation program.

In addition, such application could also contain proposals for regulatory flexibility, including, but not limited to:

- special zoning districts;
- permit process reform;
- exemptions from local ordinances; and
- other public incentives proposed in the locality's application.

Administration

The Department of Agriculture and Consumer Services would be responsible for administering the Agricultural Enterprise Zone program. In order to establish and administer the program, the Department of Agriculture and Consumer Services would be authorized to:

- Establish criteria for determining what areas qualify as Agricultural Enterprise Zones;
- Monitor the implementation and operation of the Agricultural Enterprise Zone program;
- Conduct a continuing evaluation program of Agricultural Enterprise Zones;
- Assist cities, towns and counties in obtaining the reduction of regulations within Agricultural Enterprise Zones; and
- Administer and enforce the regulations promulgated pursuant to the Agricultural Enterprise Zone Act.

The Department of Agriculture and Consumer Services would be required to periodically review the effectiveness of state and local incentives in increasing investment and employment in each Agricultural Enterprise Zone, and make an annual report to the Senate Finance Committee, the Senate Committee on Agriculture, Conservation and Natural Resources, the House Finance Committee, and the House Committee on Agriculture, Chesapeake and Natural Resources.

Other Legislation

House Bill 1045 is identical to this bill.

cc : Secretary of Finance

Date: 1/30/2004 dtm