DEPARTMENT OF TAXATION
2017 Fiscal Impact Statement

1. Patron William M. Stanley, Jr.

2. Bill Number SB 798

House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
X **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee House Finance

4. Title Income Tax; Subtraction for Sale of Crops to Licensed Virginia-Breweries

5. Summary/Purpose:

This bill would provide an individual income tax subtraction for any income of a taxpayer engaged in the business of farming as defined under federal law attributable to the sale of barley, hops, wheat, or other crops grown by the taxpayer to a brewery licensed in Virginia. A taxpayer is generally considered engaged in the business of farming pursuant to federal law to the extent that he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant.

This bill would be effective for taxable years beginning on or after January 1, 2017.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Not available. (See Line 8.)

8. Fiscal implications:

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2018. It is uncertain how much barley, wheat, hops, or other crops are sold by Virginia taxpayers to breweries licensed in Virginia. However, Virginia is not a major producer of the type of crops traditionally used by breweries. Because this subtraction would only be available for income from sales of such crops, the revenue impact of this bill is unknown, but is expected to be minimal.

According to a January 22, 2017 Fiscal Impact Review prepared by the Joint Legislative Audit and Review Commission ("JLARC"), this bill is estimated to have a negative General Fund revenue impact of up to $56,000 at most from sales of hops and barley in Fiscal

Year 2018. JLARC also indicated that any negative General Fund revenue impact from sales of crops other than hops and barley would likely be minimal.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

<u>Federal Incentives for Farmers</u>

While federal tax law has no provision that specifically benefits farmers who make sales of agricultural products to breweries, farmers may receive the following federal tax preferences:

- **Three-year income averaging**: An individual engaged in a farming or fishing business may elect three-year averaging of elected farm income for income tax purposes. Income averaging for farmers and fishermen provides a way to balance an income tax burden over several years, reducing the effects of both profitable years and loss years.

- **Longer net operating loss ("NOL") carryback period**: Although net operating losses ("NOLs") generally may be carried back only two years, farmers may receive a five-year carryback for NOLs attributable to farming losses. "Farming losses" are any losses related to the income and deductions of a farming business.

- **Favorable accounting and inventory methods**: Although the accrual method of accounting is normally required of taxpayers engaged in the production and sale of goods where inventories are a material income determining factor, farmers are generally given the choice of reporting income under the cash or accrual method of accounting. A hybrid method combining the features of cash and accrual accounting may be used under some circumstances.

- **Income deferrals:** Farmers can generally elect to defer reporting certain insurance proceeds and federal disaster payments until the taxable year after the year of the destruction or damage to, or inability to plant, the crops, if he shows that under his practice, the income from the crops would be reported in a later year. Such deferral also may be elected for income from livestock sold on account of a drought, flood or other weather-related condition so severe the sale had to take place in an earlier year than normal.

- **Deduction of items normally capitalized**: A farmer may generally elect to have the uniform capitalization rules not apply to any plant produced in his farm business, so he may currently deduct all otherwise deductible costs incurred during a pre-productive period. A pre-productive period begins when the farmer first acquires the seed or plant, and ends when the plant produces marketable quantities or is reasonably expected to be sold or otherwise disposed of. In addition, a farmer may deduct currently, as business expenses, certain outlays for soil and water conservation or erosion prevention that are incurred to maintain the farm and preserve its normal productivity, and not to increase its value or convert it to a new use.

Virginia Incentives for Farmers

While current Virginia tax law has no provision that specifically benefits farmers who make sales of agricultural products to breweries, farmers may receive the following Virginia tax preferences:

- **Farm wineries and vineyards tax credit**: An individual and corporate income tax credit is available for Virginia farm wineries and vineyards for qualified capital expenditures made in connection with the establishment of new Virginia farm wineries and vineyards and capital improvements made to existing Virginia farm wineries and vineyards.

- **Agricultural best management practices tax credit**: An individual and corporate income tax credit is available for taxpayers that are engaged in agricultural production for market and have a soil conservation plan in place to provide significant improvement to water quality in Virginia's streams, rivers, and bays.

- **Sales tax exemption for farmers**: Farmers are exempt from the sales and use tax with respect to their purchase and use of certain agricultural products, seafood, agricultural equipment, and materials used in agriculture.

- **Sales tax exemption for farmers markets**: Sales of agricultural produce and eggs are exempt from sales and use tax when such items are raised and sold by an individual at retail in local farmers markets and at roadside stands, provided that the annual income from such sales by the agricultural or egg producer do not exceed $1,000.

- **Local option for reduced property taxation for agriculture**: Localities are permitted to assess real estate devoted to agricultural use based on “use value” instead of “fair market value.” This may result in a lower property tax liability.

Proposed Legislation

This bill would provide an individual income tax subtraction for any income of a taxpayer engaged in the business of farming as defined under federal law attributable to the sale of barley, hops, wheat, or other crops grown by the taxpayer to a brewery licensed in Virginia. Under federal law, a taxpayer is generally considered engaged in the business of farming pursuant to federal law to the extent that he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant. Federal law further provides that a taxpayer who receives a rental (either in cash or in kind) which is based upon farm production is engaged in the business of farming. Federal law also states that a taxpayer is engaged in “the business of farming” if he is a member of a partnership engaged in the business of farming.

This bill would be effective for taxable years beginning on or after January 1, 2017.

cc : Secretary of Finance

Date: 2/3/2017 JJS
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