DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron Tony O. Wilt

2. Bill Number HB 2680

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

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

3. Committee House Finance

4. Title Individual Income and Corporate Income Tax; Milk Production Tax Credit

5. Summary/Purpose:

This bill would provide an individual income tax and corporate income tax credit for taxpayers that own a qualifying farm to the extent that they make sales of USDA Class I or Class II milk at a price that is less than the producer price determined each month by the State Milk Commission. The amount of the credit would be equal to:

- $1,000 per million pounds for the first seven million pounds of milk sold below the producer price;
- $500 per million pounds of milk sold below the producer price for amounts greater than seven million pounds, but not greater than 20 million pounds;
- $200 per million pounds of milk sold below the producer price for amounts greater than 20 million pounds, but not greater than 50 million pounds; and
- $100 per million pounds of milk sold below the producer price for amounts greater than 50 million pounds, but not greater than 90 million pounds.

This credit would not be subject to an annual credit cap.

This bill is effective for taxable years beginning on and after January 1, 2019, but before January 1, 2024.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

8. Fiscal implications:

Administrative Costs

Department of Taxation and Department of Conservation and Recreation

The Department of Taxation ("the Department") and the Department of Conservation and Recreation ("DCR") consider implementation of this bill as routine, and do not require additional funding.

Department of Agriculture and Consumer Services

The Department of Agriculture and Consumer Services ("VDACS") has determined that implementation of this bill would have no significant administrative impact on the agency. However, should the Patron's intent be for the State Milk Commission to be required to calculate a "producer price" that better reflects the actual cost of production, the State Milk Commission would need to calculate such price using data from the USDA's Economic Research Service. For purposes of conducting such calculations, the State Milk Commission would need $28,831 annually through 2025 to hire one wage employee for 20 hours per week.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2020. In 2017, there were 615 dairy farms operating in Virginia. In addition, from 2013 through 2017, Virginia farmers sold approximately 1.7 billion pounds of milk per year. However, it is unknown to what extent these Virginia dairy farms and the milk that they sell would qualify for purposes of this credit.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Conservation and Recreation
Department of Agriculture and Consumer Services

10. Technical amendment necessary: No.

11. Other comments:

Federal Tax Preferences for Farmers

While federal tax law has no provision that specifically benefits farmers who make sales of milk below the producer price, 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") carryforward period**: Prior to the enactment of the federal Tax Cuts and Jobs Act ("TCJA"), farmers were eligible to receive a five-year carryback for NOLs attributable to farming losses. After the enactment of the TCJA, a farmer may now only carryback NOLs for two years, but may carry NOLs forward indefinitely. The TCJA also limited NOL deductions to 80 percent of taxable income.

- **Favorable accounting and inventory methods**: Although the accrual method of accounting is normally required for 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. Under the TCJA, more farmer corporations and partnerships are eligible to use the cash method of accounting. A hybrid method combining certain features of the cash and accrual method of accounting may be used under some circumstances.

- **Income deferrals:** Farmers may generally elect to defer reporting of certain insurance proceeds and federal disaster payments until the taxable year after the year of the destruction or damage to, or inability to plant, crops. These payments are deferred until the taxable year after the year the crops are either damaged/destroyed, or the farmer is unable to plant. Such deferral may also be elected for income from livestock sold on account of a drought, flood or other weather-related condition so severe that the sale had to take place in an earlier year than normal.

- **Deduction of items normally capitalized**: Certain farmers may generally elect to have the uniform capitalization rules not apply to any plant with a pre-productive period of 2 year or less. This allows a farmer to immediately deduct all otherwise deductible costs incurred during the 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.

<u>Virginia Tax Incentives for Farmers</u>

While Virginia does not currently provide a tax incentive specifically for farmers who make sales milk below the produce price, farmers may be eligible for the following Virginia tax incentives:

- **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 to 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 and corporate income tax credit for taxpayers that own a qualifying farm to the extent that they make sales of USDA Class I or Class II milk at a price that is less than the producer price determined each month by the State Milk Commission. The amount of the credit would be equal to:

- $1,000 per million pounds for the first seven million pounds of milk sold below the producer price;
- $500 per million pounds of milk sold below the producer price for amounts greater than seven million pounds, but not greater than 20 million pounds;
- $200 per million pounds of milk sold below the producer price for amounts greater than 20 million pounds, but not greater than 50 million pounds; and
- $100 per million pounds of milk sold below the producer price for amounts greater than 50 million pounds, but not greater than 90 million pounds.

This credit would not be subject to an annual credit cap.

"Qualifying farm" would be defined as a dairy farm that possesses a:

- Grade A permit issued by VDACS and has voluntarily implemented either a nutrient management plan that has been approved, or is currently being reviewed by DCR; or

- Resource management plan and has been certified as having implemented the plan, or be in the process of having the plan reviewed by DCR or a local soil and water conservation district.

If the amount of credits exceeds the taxpayer's tax liability for the taxable year, the taxpayer would be allowed to carry over the excess for credit against income taxes for the next five years or until the total amount of the tax credit has been taken, whichever occurs first.

Credits granted to a partnership, electing small business corporation (S corporation), or limited liability company would be required to be allocated to the individual partners, shareholders, or members, respectively, in proportion to their ownership or interest in such business entity.

The Department, in consultation with the VDACS and DCR, would be required to develop guidelines, exempt from the provisions of the Administrative Process Act, for claiming this credit.

This bill would be effective for taxable years beginning on and after January 1, 2019, but before January 1, 2024.

cc : Secretary of Finance

Date: 1/24/2019 RWC
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