DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron William M. Stanley, Jr.

2. Bill Number SB 1001
House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. Committee Senate Finance

4. Title Individual Income Tax; Subtraction for Sales of Certain 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 attributable to the sale of barley, hops, wheat, or other crops grown by the taxpayer to a brewery licensed in Virginia. A taxpayer would generally be considered engaged in the business of farming to the extent that it 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, 2019.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

The Department of Taxation 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 2020. It is uncertain how much barley, wheat, hops, or other crops are sold by Virginia individual income taxpayers to breweries licensed in Virginia. In addition, the extent to which taxpayers would claim this subtraction is unknown. 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 arising from sales of such crops, the revenue impact of this bill would likely be minimal.

During the 2017 Session, the General Assembly considered legislation identical to this bill, 2017 Senate Bill 798. According to a January 22, 2017 Fiscal Impact Review prepared by the Joint Legislative Audit and Review Commission (“JLARC”), 2017 Senate

Bill 798 was estimated to have a negative General Fund revenue impact of up to $56,000 per year from sales of hops and barley. 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 Tax Preferences 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") 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 of agricultural products to Virginia licensed breweries, 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 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 would generally be considered engaged in the business of farming to the extent that it 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, 2019.

cc : Secretary of Finance

Date: 1/11/2019 RWC
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