SB 860

Department of Legislative Services

Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 860 (Senator Middleton)
Budget and Taxation Rules and Executive Nominations

Income Tax - Subtraction Modification - Commercial Fertilizer

This bill creates a subtraction modification against the State income tax for the qualified commercial fertilizer costs incurred by a taxpayer. The costs must be necessary to transition an agricultural production from using animal manure as fertilizer. The amount of qualified expenses must be certified by the Maryland Department of Agriculture (MDA). In order to claim the subtraction modification, a taxpayer must submit certification from MDA stating that (1) the taxpayer has documentation of the historical use of animal manure under prior crop rotations and (2) the expenses are necessary to comply with regulations adopted by MDA. Any unused amount of the subtraction modification can be carried forward for five tax years.

The bill takes effect July 1, 2016, and applies to tax years 2017 through 2025. The bill terminates June 30, 2026.

Fiscal Summary

State Effect: General fund revenues may decrease beginning in FY 2018 due to subtraction modifications being claimed against the income tax. The amount of the revenue loss depends on the amount of qualifying commercial fertilizer expenses incurred in each year, as discussed below. Potential minimal decrease in Transportation Trust Fund (TTF) and Higher Education Investment Fund (HEIF) revenues beginning in FY 2018. General fund expenditures may increase beginning in FY 2018 due to implementation costs at MDA.

Local Effect: Local income tax revenues and local highway user revenues may decrease beginning in FY 2018 due to subtraction modifications claimed against the personal and corporate income tax. Expenditures are not affected.

Small Business Effect: Minimal. Small businesses that incur qualified commercial fertilizer costs will benefit from the subtraction modification.

Analysis

Current Law: No exact State tax benefit exists. Maryland income tax law provides a subtraction modification for the specified expenses incurred by a taxpayer for the purchase and installation of qualified conservation tillage equipment. Taxpayers must meet certain requirements and receive certification from MDA in order to claim the subtraction modification.

Farm operators can typically expense or depreciate the costs associated with purchasing and applying fertilizer, which typically lowers federal and State income tax liability.

Background: Poultry manure is a waste product from the poultry industry and a fertilizer for the domestic grain industry – poultry manure is now being used on the Eastern Shore in place of inorganic fertilizers. However, poultry manure has a 1.0 to 1.5 ratio of nitrogen to phosphorus, which is a lower ratio than the 3.0 to 1.0 ratio of nitrogen to phosphorus needed in a corn crop. As a result, the poultry manure creates an imbalance in the phosphorus balance in the soil.

The objective of the Phosphorous Management Tool (PMT), developed by the University of Maryland, is to identify critical areas where there is high potential for phosphorus loss due to high potential for transport to nearby surface waters and a large source of phosphorus, and also to encourage the use of management practices in those critical source areas that protect water quality. Adopting the PMT is an element of Maryland's Phase II Watershed Implementation Plan (WIP), the federally mandated document that outlines specific steps the State will take to protect and restore the Chesapeake Bay under the Total Maximum Daily Load (TMDL). TMDL sets forth specific pollution reduction requirements for Maryland and other jurisdictions within the bay watershed. All reduction measures must be in place by 2025, with at least 60% of the actions completed by 2017. The U.S. Environmental Protection Agency (EPA) required each bay jurisdiction to develop WIPs detailing the strategies and specific actions that will be implemented to reduce pollution. Phase I WIPs were completed in 2010, and more detailed Phase II WIPs were completed in early 2012. A Phase III WIP, which must be submitted to EPA in 2018, will ensure that all practices are in place by the 2025 deadline.

Regulations implementing the PMT have been proposed over the past two years, and MDA submitted regulations for the phosphorus management tool on November 14, 2014. Due to concerns about the impact of the implementation of the PMT on agricultural operations, the General Assembly adopted budget bill language in the 2014 session restricting

MDA funding, except for funds relating to the cost of an economic impact analysis, for final development and submission of phosphorus management tool regulations until MDA submitted a full economic analysis of the impact of the proposed regulations on the State's Chesapeake Bay restoration efforts and on a person who is required to have a nutrient and management plan for nitrogen and phosphorus.

MDA submitted on November 7, 2014, an analysis conducted by the Business Economic and Community Outreach Network (BEACON) at Salisbury University. The report estimated the potential costs and benefits of PMT implementation under three different scenarios and included policy options for the State to provide financial assistance to impacted farmers. The proposed PMT regulations were published for public notice and comment in the December 1, 2014 issue of the *Maryland Register*. The regulations were adopted by MDA in January 2015, but the adoption letter was subsequently withdrawn. The Secretary of Agriculture proposed new regulations in the April 3, 2015 issue of the *Maryland Register*. In its most recent evaluation of Maryland's progress in implementing the milestones associated with the bay TMDL, EPA noted that the failure to adopt PMT regulations was a "shortfall" in the State's otherwise sufficient progress to date.

State Revenues: Subtraction modifications may be claimed beginning in tax year 2017. As a result, general fund revenues may decrease beginning in fiscal 2018 due to subtractions claimed against the personal and corporate income tax. TTF and HEIF revenues may decrease beginning in fiscal 2018 due to subtraction modification claims against the corporate income tax. The amount of the revenue loss depends on the difference in the cost in acquiring and applying commercial fertilizer compared to animal manure, the amount of acres impacted, and the specifics of any regulations adopted.

MDA advises that, based on the BEACON report and University of Maryland estimates, a total of $4.2 million in qualified commercial fertilizer costs may be deducted by taxpayers. Based on these estimates, general fund revenues may decrease by $100,000 in fiscal 2018 and $130,000 in fiscal 2019. This estimate is based on the following assumptions:

- 228,000 tons of poultry litter will no longer be applied to agricultural land as a result of PMT regulations;
- poultry litter is applied at a rate of 2 tons per acre;
- the total cost per acre of using and applying poultry litter is equal to $72, compared to a cost per acre of $108 for commercial fertilizer;
- all subtraction modifications are claimed against the personal income tax; and
- PMT regulations will be phased in.

State Expenditures: MDA advises that it will incur additional costs beginning in fiscal 2018 as a result of hiring one part-time staff position to certify eligibility for the subtraction modification and the amount of qualified commercial fertilizer costs. As a result, general fund expenditures increase by $12,300 in fiscal 2018, which reflects a January 1, 2018 hiring date. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position	0.2
Salary and Fringe Benefits	$7,349
Operating Expenses	4,912
Total FY 2018 Expenditures	**$12,261**

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Local Revenues: Local income tax revenues and local highway user revenues may decrease beginning in fiscal 2018 due to subtraction modifications claimed against the personal and corporate income tax. Under the assumptions above, local revenues will decrease by $64,500 in fiscal 2018 and $84,000 in fiscal 2019.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Department of Agriculture, Salisbury University, University of Maryland, Department of Legislative Services

Fiscal Note History:	First Reader - March 20, 2015
mar/jrb	Revised - Senate Third Reader - April 13, 2015

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