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Livestock Farm Investment Tax Credit
(General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 2005-07 Budget Summary: Page 178, #8]

CURRENT LAW

The dairy investment tax credit is provided under the state individual and corporate income and franchise taxes and is equal to 10% of the amount paid for modernization or expansion related to the operation of claimant's diary farm. The credit may be claimed for tax years that begin after December 31, 2003 and before January 1, 2010. The maximum aggregate amount of credits that a taxpayer may claim is $50,000. The credit cannot be claimed for any amounts also claimed as business expense deductions. Unused credit amounts can be carried forward up to 15 years to offset future tax liabilities.

GOVERNOR

Modify provisions of the current dairy investment tax credit to create a livestock farm investment tax credit. The new livestock farm investment tax credit would replace the dairy investment credit, and provide a tax credit for livestock farm modernization or expansion, rather than dairy farm modernization or expansion. The tax credit would continue to equal 10% of the amounts paid for investment activities. Current provisions specifying the types of eligible investment activities, tax credit carryforwards, the $50,000 limit on aggregate credit claims, the treatment of pass-through entities [partnerships, S corporations, and limited liability companies (LLCs)], the 2010 sunset, and administration would apply to the new tax credit.

DISCUSSION POINTS

1. The dairy investment tax credit was created by 2003 Wisconsin Act 135. For the

purpose of claiming the credit, dairy farm modernization or expansion means the construction, improvement, or acquisition of buildings or facilities, or the acquisition of equipment for dairy animal housing, confinement, animal feeding, milk production, or waste management, including the following, if used exclusively related to dairy animals: (a) freestall barns; (b) fences; (c) watering facilities; (d) feed storage and handling equipment; (e) milking parlors; (f) robotic equipment; (g) scales; (h) milk storage and cooling facilities; (i) bulk tanks; (j) manure pumping and storage facilities; (k) digesters; and (l) equipment used to produce energy. Dairy animals include heifers raised as replacement dairy animals. Dairy farm includes a facility used to raise heifers as replacement to dairy animals.

Partnerships, LLCs, and S corporations cannot claim the tax credit, but eligibility for, and the amount of, the credit is based on each entity's payment of eligible expenses. A partnership, LLC, or S corporation is required to compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to each of them. Partners, members of LLCs, and shareholders of S corporations claim the credit in proportion to their ownership interest.

DOR administers the tax credit, and provisions related to change of business or ownership and timely claims apply to the dairy farm investment tax credit.

The estimated fiscal effect of the dairy investment tax credit under Act 135 was an annual reduction in state income and franchise tax revenues of $5.7 million.

2. As noted, under the provisions of AB 100, the current dairy investment tax credit would be modified to provide a 10% livestock investment tax credit (up to the aggregate maximum of $50,000) for amounts invested in the same types of modernization or expansion investments that qualify for the current dairy investment tax credit. "Livestock" would be defined as domestic animals used in the state in the production of food, fiber, or other animal products and would include bovine animals, swine, poultry, fish, sheep, and goats. "Livestock" would not include equine animals, deer, ratites (flightless birds such as ostrich or emu), camelidae (camels and llamas), or mink. Current definitions of dairy animals and farms would be deleted.

The new provisions would first apply for taxable years beginning on January 1 of the year in which the bill takes effect, except that if the bill takes effect after July 31, the provisions would first apply to taxable years beginning on January 1 of the following year. The estimated fiscal effect of these provisions would be a reduction in state income and franchise tax revenues of $1,714,600 in 2006-07. The administration's intent is for the new provisions to first apply to tax year 2006. If the Committee chooses to adopt the Governor's proposal, the effective date could be changed to specify that the new credit would first apply to tax year 2006 to avoid any potential revenue loss in 2005-06.

3. The Budget in Brief indicates that the dairy investment tax credit was enacted to promote investments in modernizing dairy operations. This credit would help the dairy industry modernize to enable it to compete in a global market place. The credit would be expanded in AB 100 to include other livestock facilities to support modernization of other sectors of the agricultural economy, including cattle, hogs and aquaculture.

4. On March 16, 2005 the State Assembly, by a vote of 95 to 0, passed Assembly Substitute Amendment 1 to Assembly Bill 145, which would create a livestock investment tax credit under the state individual and corporate income and franchise taxes. ASA 1 would create a separate livestock investment tax credit, in addition to the current dairy investment tax credit. The livestock investment tax credit would also equal 10% of the amount paid by the claimant in the tax year for livestock modernization or expansion related to the operation of the claimant's livestock farm. The maximum aggregate amount of credits that a taxpayer could claim would be $50,000. The credit could not be claimed for any amounts also claimed as business expense deductions. Unused credit amounts could be carried forward up to 15 years to offset future tax liabilities.

The definition of "livestock farm modernization or expansion" would be similar to that included in AB 100, but the specified equipment and structures would be somewhat different. "Livestock modernization and expansion" would mean the construction, improvement, or acquisition of buildings or facilities, or the acquisition of equipment, for livestock housing, confinement, feeding, or waste management, including the following, if used exclusively related to livestock and if acquired and placed in service in the state during tax years that begin after December 31, 2004, and before January 1, 2011: (a) birthing structures; (b) rearing structures; (c) feedlot structures; (d) feed storage and handling equipment; (e) fences; (f) watering facilities; (g) scales; (h) manure pumping and storage facilities; (i) digesters; (j) equipment used to produce energy; (k) fish hatchery buildings; (l) fish processing buildings; and (m) fish rearing ponds. "Livestock" would mean cattle, not including dairy animals (eligible under the dairy credit); swine; poultry, not including farm-raised birds and ratites; fish that are raised in acquaculture facilities; sheep; and goats.

The provisions of the current dairy farm credit regarding pass-through entities would apply to the new credit. The substitute amendment would also specify that, if two or more persons owned and operated a dairy or livestock farm, each person could claim the dairy or livestock tax credit in proportion to his or her ownership interest, subject to the $50,000 maximum limit on aggregate tax credit claims. In addition, the term "used exclusively" applied to equipment or structures for which both the dairy and livestock tax credits would be claimed would be defined to mean used to the exclusion of all other uses, except for use not exceeding 5% of total use.

DOR would administer the tax credit, and provisions related to change of business or ownership and timely claims would apply to the dairy farm investment tax credit.

ASA 1 to AB 145 would first apply to tax year 2005, and would reduce state income and franchise tax revenues by an estimated $1.9 million in 2005-06 and 2006-07.

5. The Administration has indicated that it would support replacing the proposed expanded livestock tax credit included in AB 100 with the provisions of ASA 1 to AB 145. Consequently, the Committee may wish to delete the proposed livestock tax credit included in AB 100, with the provisions of ASA 1 to AB 145 that would create a separate livestock tax credit. This would reduce state income and franchise tax revenues buy an additional estimated $1.9 million in 2005-06 and by $185,400 in 2006-07, compared to AB 100. As an alternative, the Committee could

modify the provisions to make the new credit effective for tax years beginning after December 31, 2005, and before January 1, 2012. This would eliminate the additional $1.9 million cost in 2005-06. Conversely, the Committee could delete the livestock tax credit provisions from the bill and allow ASA 1 to AB 145 to pass as separate legislation.

6. The dairy and livestock investment tax credits are designed to encourage investment in related equipment and structures by providing more favorable treatment relative to other investments. The tax credits are intended to reduce taxes and increase the after-tax cash flow to farmers. The new equipment and structures can increase productivity, product quality, and output. As a result, the competitive position of these farms would improve. However, agriculture is a capital-intensive industry. To the extent the tax credit and not market forces is the primary determinant of how much investment in dairy and livestock equipment and structures occurs, the allocation of resources to different agricultural sectors and industries in general may not be optimal from broader resource allocation perspective. In addition, tax incentives can have impacts that are unintended or counter to other tax policy goals. Investment tax credits can cause the business to substitute capital for labor and reduce overall employment in the industry. More efficient production can increase output, and reduce prices and income in the long run. Research studies have found that, for farmers whose primary source of income was from farming, federal income tax rates were relatively flat suggesting that larger, higher income farmers were able to utilize investment incentives to offset higher marginal income tax rates. However, tax-induced behavior is likely to be relatively less important when compared with non-tax factors such as weather and technology development.

ALTERNATIVES

1. Adopt the Governors' recommendation to convert the current dairy investment tax credit to a livestock farm investment tax credit with a modification to specify that the new credit would first apply to tax years beginning after December 31, 2005, as intended by the administration. The new livestock farm investment tax credit would replace the dairy investment credit, and provide a tax credit for livestock farm modernization or expansion, rather than dairy farm modernization or expansion.

2. Delete the Governor's recommendation, and instead include the provisions of ASA 1 to AB 145, that would create a separate livestock tax credit for tax years that begin after December 31, 2004, and before January 1, 2011.

Alternative 2	GPR-REV
2005-07 REVENUE (Change to Bill)	- $2,085,400

3. Delete the Governor's recommendation, and instead include the provisions of ASA 1 to AB 145, that would create a separate livestock tax credit. Specify that the new credit would be available for tax years that begin after December 31, 2005, and before January 1, 2012.

Alternative 3	**GPR-REV**
2005-07 REVENUE (Change to Bill)	**-** $185,400

4. Maintain current law (delete provision from the bill).

Alternative 4	**GPR-REV**
2005-07 REVENUE (Change to Bill)	$1,714,600

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