

Fiscal Note

BILL # HB 2275

TITLE: TPT exemption; crop production tools

SPONSOR: Dunn

STATUS: As Amended by Senate FIN

PREPARED BY: Sam Beres

REVISED

Description

The bill would exempt a variety of crop production products such as fertilizers and pesticides from state transaction privilege tax (TPT) as well as use tax beginning in FY 2020.

Estimated Impact

The JLBC Staff estimates that the bill would reduce state General Fund revenue by \$(14.7) million annually beginning in FY 2020. This estimate is based on an analysis of U.S Department of Agriculture (USDA) data from 2017 on the sale of fertilizer and other agricultural chemicals in Arizona.

The Department of Revenue (DOR) had previously estimated that the bill would result in an annual General Fund revenue loss of \$(17.1) million. This estimate was based on USDA data from 2012, which has been updated since DOR provided our office with their estimated cost of the bill. In our original fiscal note, the JLBC Staff had the same estimate as DOR. Our estimate has since been updated to reflect the 2017 USDA data.

As a fiscal note, our analysis does not opine on any legal issues associated with this bill.

Analysis

Under current law, statute exempts seeds, seedlings, roots, bulbs, cuttings, and other propagative materials from state TPT. According to DOR's 2018 Tax Expenditure Report, this exemption had a state revenue impact of \$(1.4) million in FY 2017, of which \$(1.0) million would have gone to the General Fund.

According to DOR, this exemption does not apply to other products used in commercial agriculture such as fertilizers and pesticides. Various agricultural product suppliers have filed tax appeals contending that 'propagative materials' should include these types of products, thus exempting them from TPT. The primary challenge on this subject is *Wilbur Ellis vs Arizona Department of Revenue*. In reviewing this case, the Arizona Court of Appeals upheld the DOR interpretation that fertilizer does not constitute propagative material under the law. Under the bill, these products would be prospectively exempted from TPT.

According to the USDA 2017 Census of Agriculture, Arizona farmers spent \$386 million on fertilizer and other agricultural chemicals in 2017 (the most recent year for which data is available). The Census of Agriculture data is published every 5 years. Between the 2012 census and 2017 census, purchases of these products increased by an average rate of 1.7% per year. Assuming that these purchases continued to increase at this rate, estimated expenditures on fertilizer and other agricultural chemicals would be \$399 million in FY 2020. Both the JLBC Staff and DOR assume that these expenditures are being taxed at the state level under current law, and that these expenses would no longer be subject to tax under HB 2275.

Based on the state's TPT distribution formula, exempting these annual expenditures would result in a General Fund revenue loss of \$(14.7) million annually. This impact would begin in FY 2020.

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JLBC

The Arizona Nursery Association (ANA) gathered information from several taxpayers in 2018 that sell products that would be exempt under the bill. Based on this information, ANA estimates that annual state revenue losses would be between \$(10.0) million and \$(12.0) million for both fertilizer and non-fertilizer products. Under the statutory state TPT distribution formula, 73.8% of this revenue loss, or between \$(7.3) million and \$(8.9) million, would be incurred by the General Fund annually.

In support of the lower fiscal impact estimate, proponents of the bill have noted that the number of farms in Arizona that purchase fertilizer products has declined. Between 2012 and 2017, according to the same USDA data set that was used in our staff's analysis, the number of farms that purchase fertilizer declined from 3,430 in 2012 to 2,794 in 2017. Similarly, the number of Arizona farms that purchase other agricultural chemicals declined from 3,407 to 2,182 during the same period. This same data source, however, shows that the total value of the purchases of both of these product types increased from \$355 million to \$386 million during this same time span.

The price of fertilizer can fluctuate significantly. The JLBC Staff assumes that overall fertilizer and other chemical purchases will increase by 1.7% annually between 2017 and 2019, the same annual rate as between 2012 and 2017. If the price of fertilizer and other chemicals were to decline significantly, the revenue impact of the bill could be lower than our estimate. Similarly, if the price of these products were to increase significantly, then the revenue impact could be greater.

The Producer Price Index (PPI), which is produced by the Bureau of Labor Statistics, measures changes in prices that producers receive for certain products. The PPI data shows that prices of fertilizer products declined by (37)% from 2012 through 2017. These prices, however, are captured in the overall increase in total purchases as noted above. The PPI data also shows that these prices have increased since 2017.

Local Government Impact

Table 1 reflects the distribution of the revenue impact on various entities.

Table 1	
State and Local Government Impact	
(\$ in millions)	
	<u>FY 2020</u>
General Fund	\$(14.7)
Counties (State Shared TPT)	(3.2)
County Excise	<u>(2.8)</u>
Total County Impact	(6.0)
City (State Shared TPT)	(2.0)
Total	\$(22.7)