

ENVIRONMENTAL LAW INSTITUTE  
RESEARCH REPORT

# CHESAPEAKE 2000 TAX POLICY STUDY

August 2003





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TAX POLICY STUDY**

Environmental Law Institute

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## CHAPTER ONE - INTRODUCTION

This study by the Environmental Law Institute is designed to assist the signatories to the Chesapeake Bay Agreement (Chesapeake 2000) to identify tax policies that may affect the parties' abilities to meet the sound land use goals of the Agreement. With respect to taxation, the parties agreed to:

*[R]eview tax policies to identify elements which discourage sustainable development practices or encourage undesirable growth patterns [and]*

*Promote the modification of such policies and the creation of tax incentives which promote the conservation of resource lands and encourage investments consistent with sound growth management principles.*<sup>1</sup>

The study focuses on the state tax systems of Maryland, Pennsylvania, and Virginia, which also define the rules under which units of local government levy taxes. The study does not address District of Columbia taxes because most of the Chesapeake Bay watershed's resource lands and land development decisions are in the states.<sup>2</sup>

### OVERVIEW

Decisions about what to tax and what to exempt from taxation, what mix of taxes to use to fund government operations, whether to dedicate particular tax revenues to particular purposes, and what incentives to offer in the tax code for desired behaviors, all affect public and private decisions about development, revitalization, and conservation. This study focuses on the current status and general direction of the tax signals sent by the state and local systems of the Bay agreement states.

Although the Chesapeake Bay watershed states have varying reputations in terms of tax burden, the aggregate state and local tax burdens in Maryland, Pennsylvania, and Virginia are all just over 10 percent of per capita personal income, and all are lower than the U.S average of 11 percent.<sup>3</sup> Thus, the primary focus is on what is taxed and what incentives are provided, rather than upon the overall tax burden.

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<sup>1</sup> Chesapeake 2000.

<sup>2</sup> Federal tax policies also affect development choices, but are not reviewed in this study. Such a review would require further evaluation and research, including analysis of national tradeoffs and choices that reach well beyond watershed concerns. Federal tax issues are briefly described in Appendix A.

<sup>3</sup> Maryland Department of Legislative Services, "Revenue and Expenditure Comparisons for Maryland and Selected States," (Presentation to the Commission on Maryland's Fiscal Structure, August 8, 2002).

Review of tax policy must deal with a continuously moving target. State legislatures typically make several dozen changes in tax laws every year. And recent fiscal downturns facing the Bay states are likely to lead to further pressures for changes in the near term. Nevertheless, the broad policy choices recur.

The taxing powers of state and local governments are constrained by state constitutions which set forth limits or grants of authority on what can be taxed, whether and to what extent similar things can be taxed at different rates, and what classes or categories of exemption can be recognized. Limits on local governments' authority to incur debt can also affect the taxation structure, as well as state statutes that grant or withhold certain types of taxing powers from local government units of various types.

State and local tax systems are complex. In general, taxes are imposed upon income, property, sales, and certain privileges of doing business or practicing an occupation. The mixture of taxes among these subjects of taxation can produce changes in economic behavior, and hence upon development decisions. Taxation has also long been used not only as a means of providing revenues for the operation of government, but also as an incentive for certain kinds of desired behaviors. Many taxes have exemptions or incentives for charitable and civic purposes, for environmental or community revitalization activities, for job creation, for affordable housing, and for many other purposes.

## **FRAMEWORK OF REVIEW**

This study lays out the tax systems of the Chesapeake Bay Agreement states and their constituent local governments. It identifies areas where taxes may be affecting land use choices, and it analyzes tax incentives that operate in the existing system. Finally, it identifies potential modifications that may support sound land use and the goals of Chesapeake 2000.<sup>4</sup> This study describes each state system in a separate chapter. Each chapter deals first with taxes imposed and collected by the state, and second with taxes imposed and collected by local governments.

This study does not examine all sources of revenue for state and local governments. For example, lottery proceeds, corporate registration fees, bond funding, tuition payments, federal

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<sup>4</sup> The study focuses on modifications that can be made consistent with the general taxing frameworks of the Bay Agreement states, rather than proposing wholesale revisions of taxation (such as replacing income taxes with "pollution taxes," for example). Discussions with knowledgeable government and nongovernment policy makers in the region suggest that incremental innovation (including ambitious versions of such innovation) is more likely to succeed than very radical changes. The options discussed in the last chapter are based primarily on those that have been used at least in part by one or more jurisdictions within the Bay region, although some of the policy options are drawn from other places. The Bay Agreement states have each engaged in some innovations that make the region a fruitful place to draw upon for reforms.



grant funds and other funds are not addressed in this study. This study focuses rather on the major state and local taxing programs and their potential effects on decisions about land use.

The study reviews the following state taxes:

- State Income Taxes
- Other Business Taxes
- Estate and Inheritance Taxes
- State Sales and Use Taxes
- Vehicle Fuel Taxes
- Travel/Entertainment Taxes
- Real and Personal Property Taxes
- Transfer Taxes and Recording Fees
- Other Taxes

The study reviews the following local taxes:

- Real Property Taxes
- Personal Property Taxes
- Transfer Taxes and Recording Fees
- Local Income Taxes
- Local Occupation and Business Taxes
- Local Sales and Use Taxes
- Travel/Entertainment Taxes
- Impact Fees
- Other Taxes

The last chapter of the study examines issues and opportunities presented by state tax policies in the Bay Agreement states in view of their Chesapeake 2000 commitments.

## CHAPTER TWO - MARYLAND TAXES

At the state level, Maryland taxes personal and corporate income, public service company gross receipts, estates and inheritances, real property, real property transfers, sales and use, fuels, vehicle rentals, alcohol, and tobacco. Maryland's Office of the Comptroller collects most state taxes including the income tax.<sup>5</sup> The Maryland Department of Assessments and Taxation oversees assessments for local and state taxation of real property and local taxation of personal property, and collects franchise taxes on utilities.<sup>6</sup>

Maryland's local governments tax real and personal property, income, transfers of real property, amusements, and certain other activities. The 23 counties and Baltimore City are the primary local taxing jurisdictions.<sup>7</sup> Maryland also has 155 incorporated municipalities within counties that have some taxing power. Schools do not have their own taxing authority, but must rely on the taxing powers of local governments.

### STATE TAXES

#### STATE INCOME TAXES

Maryland derives approximately half of state general fund revenues from the state income tax.<sup>8</sup> Maryland bases its state income tax on the taxpayer's federal adjusted gross income, with additional adjustments. The personal income tax rate is 4.75 percent for all income in excess of \$3,000.<sup>9</sup> Maryland recognizes a standard deduction of 15 percent of the adjusted gross (subject to limits), or itemized deductions.<sup>10</sup>

Maryland's corporate income tax rate is 7 percent.<sup>11</sup> Corporate income taxes go largely to the general fund, but about 24 percent of corporate income tax receipts are designated to the

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<sup>5</sup> <http://individuals.marylandtaxes.com>.

<sup>6</sup> Maryland Department of Assessments and Taxation, Fifty-Eighth Report (Jan. 2002).

<sup>7</sup> As used in this report, the term "county" will include Baltimore City, unless otherwise indicated.

<sup>8</sup> Md. Code Ann. Tax-General 10-102, COMAR 03.04.01 et seq.

<sup>9</sup> Md. Code Ann. Tax-General 10-105 (amounts under \$3000 are taxed at 2-4 percent).

<sup>10</sup> Md. Code Ann. Tax-General 10-217. Maryland also offers a low-income tax credit for low income taxpayers below the poverty line as well as an earned income tax credit. 10-709, 10-704.

<sup>11</sup> Md. Code Ann. Tax-General 10-105.

state's Transportation Trust Fund.

## **Reductions, Exemptions, Deductions, Credits**

### *Conservation and Land Management*

Maryland offers a subtraction from adjusted gross income of 100 percent of the cost of the purchase of conservation tillage equipment used in farming. Unused portions of the resulting credit may be carried over for five years.<sup>12</sup> Maryland also offers a subtraction from adjusted gross income of 100 percent of the cost of the purchase of poultry or livestock manure spreading equipment that is calibrated to within 1.0 ton/acre and used in carrying out an approved nutrient management plan.<sup>13</sup> Maryland also offers a commercial fertilizer tax credit for three-years, up to \$4,500 per year, for 50 percent of the cost of purchase of fertilizer by farmers converting to a required approved nutrient management plan. The credit carries over for five years. It sunsets January 1, 2009.<sup>14</sup> These tax breaks are intended to support transition to nutrient management for water quality.

Maryland's Timber Stand Improvement and Reforestation Tax program (referred to as the "tax modification program") is designed to encourage reforestation and active management of forest lands under a management plan.<sup>15</sup> Taxpayers may subtract from their adjusted gross income an amount that is *double* their cost of reforestation and timber stand improvement practices (less any cost-share assistance). Eligibility requires ownership or lease of 10-500 acres of forest land capable of growing more than 20 cubic feet of wood per acre per year and available for the primary purpose of growing and harvesting trees. Use of the tax modification is, however, limited to practices installed on 10-100 acres in any one year. The taxpayer must show that, within two years after the initial certification of eligibility, there are at least 400 healthy seedlings per acre or that the timber stand improvements prescribed under the forest management plan have been successfully implemented. Practices must remain in effect for 15 years to avoid a repayment requirement.

Maryland offers an income tax credit for conveyance of a perpetual conservation easement to the Maryland Environmental Trust or the Maryland Agricultural Lands Preservation Foundation. The credit is equal to the amount by which the conveyance reduces the fair market value of the property as a whole, less any payment received for the easement. The credit in any taxable year is limited to the lesser of \$5,000 or the state income tax due, but may be carried over for 15 years subject to the same limits (thus allowing a maximum credit of \$80,000). The credit

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<sup>12</sup> Md. Code Ann. Tax-General 10-208(d).

<sup>13</sup> Md. Code Ann. Tax-General 10-208(m).

<sup>14</sup> Md. Code Ann. Tax-General 10-704.9.

<sup>15</sup> Md. Code Ann. Tax-General 10-208(i); Md. Code Ann. Nat. Res. 5-219.

may not be claimed for required dedications of land to meet density requirements or to obtain a subdivision approval or building permit.<sup>16</sup>

Maryland offers a tax credit of 100 percent of the cost for an oyster float for an individual homeowner's pier, capped at \$500 or the tax liability for that year whichever is less, with no carryover.<sup>17</sup>

Maryland offers a tax credit for employer-provided commuter benefits, of up to 50 percent for use of van pools, transit, or cash in lieu of parking, to encourage employers to subsidize alternatives to driving. The credit is capped at \$50/employee/month. Nonprofit organizations (who incur no tax liability) may apply the credit to employee withholding.<sup>18</sup>

### *Community Revitalization and Reinvestment*

Maryland offers a neighborhood stabilization income tax credit to homeowners in designated areas of Baltimore City, Baltimore County, Prince George's County, and Montgomery County in order to stimulate reinvestment and homeownership in certain neighborhoods. This income tax credit is equal to a locally-offered property tax credit (discussed below), and begins at 40 percent of property taxes and declines over ten years.<sup>19</sup>

Maryland offers certified rehabilitation income tax credits to encourage rehabilitation of structures that are listed on the National Register of Historic Places, eligible for listing and designated by a local government, located in a listed or eligible historic district, or located in a state-certified heritage area and contributing to the significance of that area. A substantial rehabilitation eligible for the credit means expenditure of at least \$5,000 for owner-occupied residential property and the greater of the adjusted cost basis or \$5,000 for other property. The tax credit is equal to 20 percent of the taxpayer's qualified rehabilitation expenses, and is capped at \$3 million for any rehabilitation. The credit is both transferable and refundable (meaning that the state will pay refunds in cash). The legislature capped the credit statewide at \$23 million in 2003 and \$15 million in 2004 for commercial properties. The credit ends June 1, 2004.<sup>20</sup>

Maryland offers taxpayers a Neighborhood and Community Assistance tax credit of 50 percent of contributions they make to an approved project operated by a tax-exempt

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<sup>16</sup> Md. Code Ann. Tax-General 10-723.

<sup>17</sup> Md. Code Ann. Tax-General 10-724.

<sup>18</sup> Md. Code Ann. Tax-General 10-715, Md. Code Ann. Environment 2-901.

<sup>19</sup> Md. Code Ann. Tax-General 10-707; Tax-Property 9-317(e), -318(d), -326.

<sup>20</sup> Md. Code Ann. Tax-General 10-704.5, Md. Code Ann. Art. 83B, section 5-801 et seq., as amended HB935, sec 24 (2003).

organization. The credit is capped at \$125,000 or the amount of tax owed in the taxable year, and total contributions eligible for all approved projects may not exceed \$2 million per fiscal year. Unused portions of the credit may be carried over for five years.<sup>21</sup>

### *Job Creation and Investment*

Maryland offers a job creation income tax credit. A business that is eligible for and receives a local property tax credit for creating 25 new permanent jobs in new or expanded premises, also is eligible to receive an income tax credit from the state. The income tax credit is measured as a portion of the incremental additional property tax imposed on the new or expanded premises, declining over seven years from 28 percent of the increased property tax in the first year to 0 in the seventh. An enhanced credit is available for large investments and creation of at least 500 new jobs. The enhanced credit is a 12-year credit of 31.5 percent of the increased property tax. These job creation tax credits are available only in priority funding areas.<sup>22</sup>

Maryland's "One Maryland" income tax credit offers a credit for project costs and start-up costs incurred in starting a new or expanded business facility in a priority funding area in a distressed county or Baltimore City, creating at least 25 new jobs. The credit for start-up costs is the lesser of 100 percent of "start-up costs" (up to \$500,000) or \$10,000 times the number of qualified employees. The credit for project costs is 100 percent of "project costs" up to \$5 million, less any credits taken in prior years. The credit is capped at the amount of income tax due as the result of the project, but may be carried over 14 years.<sup>23</sup>

Maryland offers an enterprise zone employment tax credit of \$1,000 per worker per newly created job, and up to \$6,000 over three years for economically disadvantaged workers in such jobs in enterprise zones.<sup>24</sup>

Maryland offers a research & development tax credit equal to 3 percent of Maryland-qualified research & development expenses up to a base amount, and 10 percent of the amount by which these expenses exceed a base amount. The credit expires June 30, 2006.<sup>25</sup>

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<sup>21</sup> Md. Code Ann. Tax-General 10-704.6.

<sup>22</sup> Md. Code Ann. Tax-General 10-704.8. There is a corresponding property tax credit, declining from 52 percent of incremental property tax over seven years (58.5 percent declining over 12 years for enhanced credit). Md. Code Ann. Tax-Property 9-230 (discussed below under Local Taxes).

<sup>23</sup> Md. Code Ann. Tax-General 10-714; See Md. Code Ann. Art. 83A, section 5-1501.

<sup>24</sup> Md. Code Ann. Tax-General 10-702.

<sup>25</sup> Md. Code Ann. Tax-General 10-721. The credit is based on research activities as

Maryland offers a public utility telecommunications business income tax credit equal to 60 percent of real property taxes on buildings but not land.<sup>26</sup> The state offers a similar tax credit to public utilities generating electricity or steam for sale.<sup>27</sup>

### *Energy Incentives*

Maryland offers a tax credit for solar water heating and photovoltaic systems installed between July 1, 2000 and December 31, 2004. The credit is equal to 15 percent of the installed cost, and is capped at \$2,000 for photovoltaic systems and \$1,000 for solar water heating systems.<sup>28</sup>

Maryland offers a tax credit of 0.85 cents/kwh for electricity generated from wood waste, agricultural products or residues, or landfill methane by a qualified Maryland facility placed in service between January 1, 2001 and January 1, 2005.<sup>29</sup>

Maryland offers a tax credit for allowable costs incurred on or after July 1, 2001 for new or rehabilitated “green buildings” of 20,000 square feet or greater. The building must be within a priority funding area, or a qualified brownfields site (or in the case of a rehabilitation not within either area it must not increase the square footage by more than 25 percent). Green buildings are those that meet state criteria that are “consistent with criteria set forth by the United States Green Building Council or similar criteria” and include energy efficiency and materials and design criteria. The credit is available to nonresidential buildings, residential buildings with at least 12 units, or mixed use buildings. The credit is 8 percent of allowable costs (with certain caps), or 6 percent for a less comprehensive green “base building” or green “tenant space.” Credits also cover 30 percent of the costs of each installed fuel cell, 20-25 percent of the cost of installed photovoltaic modules, and 25 percent of the costs of installed wind turbines (subject to certain caps). Statewide use of green building credits are limited between \$1 million and \$5 million in various tax years, and may in no event exceed a total of \$25 million in the aggregate. Credits may not be issued after 2011.<sup>30</sup>

Electric co-generators and electricity suppliers may take a \$3/ton credit for purchase of

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defined under the federal research and development tax credit. 26 U.S.C. 41.

<sup>26</sup> Md. Code Ann. Tax-General 10-708. The credit may not exceed the amount of income tax due and may not be carried over.

<sup>27</sup> Md. Code Ann. Tax-General 10-712.

<sup>28</sup> Md. Code Ann. Tax-General 10-719.

<sup>29</sup> Md. Code Ann. Tax-General 10-720.

<sup>30</sup> Md. Code Ann. Tax-General 10-722.

Maryland-mined coal.<sup>31</sup>

## **OTHER BUSINESS TAXES**

Maryland imposes a franchise tax on public utility companies doing business as public service companies.<sup>32</sup> On gas and electric companies the tax is 2 percent of gross receipts plus .062 cents/kwh or .402 cents/therm.<sup>33</sup> The state gives partial credits against these taxes for electricity and natural gas delivered to large industrial users.<sup>34</sup> A separate sales tax is imposed on the use of electricity not delivered by a public service company (at a rate of .062 cents/kwh), which corresponds to part of the tax imposed on public service companies.<sup>35</sup> Maryland imposes a franchise tax of 2 percent of gross receipts on telephone companies.<sup>36</sup> Maryland's former franchise tax on financial institutions was abolished in 2001, and these institutions are now subject to the corporate income tax.<sup>37</sup> The Maryland Insurance Administration administers fees and taxes on insurers. In addition to various annual fees, there is a gross premiums tax of 2 percent.<sup>38</sup>

Recording fees and corporate organization and capitalization fees are collected by the Department of Assessments and Taxation, generating about \$59 million/year. Annual filing fees were raised from \$100 to \$300 for many documents in 2003.<sup>39</sup> Finally, a Maryland business license is required for most business activities. The license helps the state track businesses for local personal property taxation (see below), but also results in some revenue to the state in connection with license fees to the Department of Business and Economic Development.

### **Reductions, Exemptions, Deductions, Credits**

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<sup>31</sup> Md. Code Ann. Tax-General 10-704.1.

<sup>32</sup> Md. Code Ann. Tax-General 8-402, 8-402.1.

<sup>33</sup> Md. Code Ann. Tax-General 8-403.

<sup>34</sup> Md. Code Ann. Tax-General 8-417.

<sup>35</sup> Md. Code Ann. Tax-General 11-1A-02, 11-1A-03. This tax does not apply to residential use, backup power, or on-site generation.

<sup>36</sup> Md. Code Ann. Tax-General 8-402, 8-403.

<sup>37</sup> Md. Code Ann. Tax-General 8-202.

<sup>38</sup> Md. Code Ann. Insurance 2-112 (fees), 6-103 (tax).

<sup>39</sup> Md. Code Ann. Corps & Assoc. 1-203, 1-204.

The job creation income tax credit also applies against the insurance premiums tax.<sup>40</sup> So does the neighborhood and community assistance contributions credit,<sup>41</sup> the historic tax credit for certified rehabilitation,<sup>42</sup> and certain other income tax credits. A credit of \$3/ton of Maryland-mined coal applies to the public utilities franchise tax.<sup>43</sup>

## **ESTATE AND INHERITANCE TAXES**

Maryland has both an estate tax and an inheritance tax. The inheritance tax is levied on the value of the bequest at a rate of 10 percent, but exempts bequests to charity, to lineal descendants and their spouses, to spouses, to parents, to grandparents, and to siblings.<sup>44</sup> Real property qualifying for use valuation as farmland or woodland may be valued by the beneficiary at such value for purposes of the inheritance tax.<sup>45</sup>

The estate tax is a “pick-up” tax in the amount of the state tax credit allowed by federal estate tax laws less the state inheritance tax. Maryland in 2002 decoupled its estate tax from federal estate tax law to avoid losing this source of revenue.<sup>46</sup>

## **STATE SALES AND USE TAXES**

The state levies a 5 percent sales and use tax on most goods and services.<sup>47</sup>

The sales tax also applies to the first retail sale of a mobile home (but the mobile home is taxed on only 60 percent of its value).<sup>48</sup> Maryland imposes a “titling” tax of 5 percent of the fair market value of motor vehicles upon sale and resale.<sup>49</sup>

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<sup>40</sup> Md. Code Ann. Tax-General 10-704.8, Tax-Property 9-230.

<sup>41</sup> Md. Code Ann. Insurance 6-105.

<sup>42</sup> Md. Code Ann. Insurance 6-105.2

<sup>43</sup> Md. Code Ann. Tax-General 8-406.

<sup>44</sup> Md. Code Ann. Tax-General 7-202, 7-204.

<sup>45</sup> Md. Code Ann. Tax-General 7-211.

<sup>46</sup> Md. Code Ann. Tax-General 7-309. The federal estate tax is discussed in Appendix A to this report.

<sup>47</sup> Md Code Ann. Tax-General 11-104.

<sup>48</sup> Id. Subsequent sales are exempt. Md. Code Ann. Tax-General 11-213.

<sup>49</sup> Dept. of Legislative Services, Transportation Trust Fund Overview (Commission on



A 5 percent excise tax is imposed on the sale of boats, with the proceeds dedicated to the Waterway Improvement Fund.<sup>50</sup>

### **Reductions, Exemptions, Deductions, Credits**

The sales and use tax does not apply to sales of food by groceries, nor to medical supplies or drugs.<sup>51</sup> The tax does not apply to agricultural items used for agricultural purposes, nor to agricultural products sold by the farmer, except nursery products.<sup>52</sup>

The tax does not apply to sales to state or local governments nor to nonprofits for purchases to carry on their work.<sup>53</sup> It does not apply to sales of buses for public transportation or to sale of transportation services.<sup>54</sup>

The tax does not apply to sales of machinery or equipment for production or pollution control, nor to sales of seafood harvesting equipment or commercial fishing vessel repair parts, nor to sales of wood products for mining or diesel fuel for reclamation of mine sites.<sup>55</sup> The tax does not apply to sales of electricity, fuels, or other utilities for commercial snowmaking.<sup>56</sup>

The tax does not apply to sales of clothes washers, room air conditioners or refrigerators meeting EnergyStar requirements; nor to fuel cells, and especially efficient heat pumps and air conditioners and water heaters purchased prior to certain dates in 2003 and 2004; nor to multifuel pellet stoves that burn field corn for heating purposes.<sup>57</sup>

Sales of electricity or gas for domestic use are not subject to sales tax where regulated under rate schedules filed with the Public Service Commission. Sales of wood or wood residues

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Maryland's Fiscal Structure, Sept. 12, 2002).

<sup>50</sup> Md. Code Ann. Nat. Res. 8-707, 8-716. In 2003 the legislature diverted \$8 million of the fund balance to the general fund, and \$11 million in 2004.

<sup>51</sup> Md. Code Ann. Tax-General 11-206(c), 11-211.

<sup>52</sup> Md. Code Ann. Tax-General 11-201.

<sup>53</sup> Md. Code Ann. Tax-General 11-220, 11-204.

<sup>54</sup> Md. Code Ann. Tax-General 11-223.

<sup>55</sup> Md. Code Ann. Tax-General 11-210, 11-218, 11-212.

<sup>56</sup> Md. Code Ann. Tax-General 11-229.

<sup>57</sup> Md. Code Ann. Tax-General 11-226.

or refuse-derived fuel for heating purposes are not subject to sales tax.<sup>58</sup>

Sales subject to tax under other laws (e.g. admissions, motor fuels) are exempt from taxation under this law.<sup>59</sup>

Boats purchased by governmental units or by approved charitable and educational institutions are not subject to the excise tax.<sup>60</sup>

## **VEHICLE FUEL TAXES**

Maryland taxes motor fuels at the rate of 23.5 cents/gal for gasoline and gasoline equivalent clean fuel gallon; 24.25 cents/gal for special fuels; 7 cents/gal aviation fuel.<sup>61</sup> The motor carrier tax is at the same rate as the fuel tax.<sup>62</sup>

Funding from the fuels taxes, from the motor vehicle titling tax of 5 percent, and from vehicle registration fees go to the Transportation Trust Fund (with part dedicated to the gasoline and motor vehicle revenue account).<sup>63</sup> Fuel revenues go to the gasoline and motor vehicle revenue account, where 30 percent of the amount is shared with local governments. There were substantial diversions to the general fund in 2003-2004 because of budget shortfalls.<sup>64</sup>

## **TRAVEL/ENTERTAINMENT TAXES**

The state levies a tax on rental cars at a rate of 23 cents per \$2 (approximately 11.5 percent tax).<sup>65</sup> Forty-five percent of the tax on rental cars goes to the Transportation Trust Fund.

## **REAL AND PERSONAL PROPERTY TAXES**

Real property is taxed primarily by the counties and municipalities, but a portion of the

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<sup>58</sup> Md. Code Ann. Tax-General 11-207.

<sup>59</sup> Md. Code Ann. Tax-General 11-221.

<sup>60</sup> Md. Code Ann. Nat. Res. 8-716.

<sup>61</sup> Md. Code Ann. Tax-General 9-301.

<sup>62</sup> Md. Code Ann. Tax-General 9-202, 9-204.

<sup>63</sup> Dept. of Legislative Services, Transportation Trust Fund Overview (Commission on Maryland's Fiscal Structure, Sept. 12, 2002).

<sup>64</sup> HB 935 (2003).

<sup>65</sup> Md Code Ann. Tax-General 11-104.

real property tax is levied by the state.<sup>66</sup> The state portion of the real property tax is dedicated to service of state indebtedness. The amount is set annually by the state Board of Public Works based on debt service needs, offset by general fund amounts appropriated to debt service.<sup>67</sup> The state tax rate has for several decades been at \$0.084 per \$100 of assessed value, but was raised to \$0.132 in 2003.

Personal property is taxed by counties and municipalities but is not taxed by the state.<sup>68</sup> However, businesses must file an annual return of business personal property with the state, accompanied by a \$100 filing fee, generating more than \$14 million per year.<sup>69</sup>

### **Reductions, Exemptions, Deductions, Credits**

The general exemptions from the state real property tax are the same as those required by state laws for the county/municipal real property tax,<sup>70</sup> but the state also has several additional exemptions, such as exemptions for property owned by a land trust certified by the Maryland Environmental Trust and used for conservation or education.<sup>71</sup> The state Homestead Tax Credit also provides that for purposes of determining the state tax, increases in assessed value for owner-occupied principal residences are capped at 10 percent over the prior year.<sup>72</sup> Local governments may adopt more restrictive caps for their property tax assessments.

### **STATE TRANSFER TAXES AND RECORDING FEES**

The state imposes a real estate transfer tax of 0.5 percent of the consideration paid (including any mortgage or deed of trust). However, for first time home buyers the rate is 0.25 percent and must be paid by the seller.<sup>73</sup> Under the law establishing a formula for allocating the proceeds, \$47 million was designated for the state's general fund, with the remainder allocated to

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<sup>66</sup> Md. Code Ann. Tax-Prop. 6-301.

<sup>67</sup> Maryland Department of Assessments and Taxation, A Homeowner's Guide to Property Taxes and Assessments.

<sup>68</sup> Md. Code Ann. Tax-Property 7-301.

<sup>69</sup> Maryland Department of Assessments and Taxation, Fifty-Eighth Report (Jan. 2002).

<sup>70</sup> Md. Code Ann. Tax-Property 7-201 through 7-241.

<sup>71</sup> Md. Code Ann. Tax-Property 7-304. Such property is likely also eligible for county or municipal exemptions either under the general exemptions or local exemptions.

<sup>72</sup> Md. Code Ann. Tax-Property 9-105. The county and municipal property assessment increases may be capped at a lower rate. See discussion below.

<sup>73</sup> Md. Code Ann. Tax-Property 13-202.

specified conservation purposes described below. However, the general fund share was increased to \$102 million in the fiscal year beginning July 2003, and half the amount of receipts for the 2004 year in order to meet budget shortfalls. In addition to the general fund designation, three percent is dedicated to administration of Program Open Space. The remainder of the funds are allocated as follows: 76.15 percent to Program Open Space for land acquisition, 17.05 percent for the Maryland Agricultural Land Preservation Fund, 5 percent for the Rural Legacy Program, and 1.8 percent for the Heritage Conservation Fund.<sup>74</sup>

In addition to the state transfer tax, Maryland also levies a transfer tax on the conveyance of agricultural lands.<sup>75</sup> This additional tax is intended to inhibit and mitigate the conversion of agricultural lands to nonagricultural uses. The agricultural land transfer tax is 5 percent of the consideration paid for transfers of 20 or more acres (4 percent for transfers less than 20 acres in agricultural use; 3 percent for transfers less than 20 acres assessed as improved agricultural land or agricultural land with site improvements.) If prior to transfer, the land was not taxed at agricultural use value (see discussion of use value assessment below),<sup>76</sup> the agricultural land transfer tax is reduced by 25 percent for each full year during which the higher assessed value was used – thus the tax does not apply to land taxed for the four previous years at its fair market assessment.<sup>77</sup> The agricultural land transfer tax is not imposed on the value of improvements, nor is it imposed on split-offs of small parcels to the owner or immediate family members for their own residential use.<sup>78</sup>

Each county remits to the Comptroller all of the agricultural land transfer tax that comes from parcels that are entirely woodland, and 2/3 of the remaining revenue from agricultural lands (1/3 in Montgomery County). The Comptroller deposits up to \$200,000 annually from the forest lands tax into the state's Woodland Incentives Fund.<sup>79</sup> The remaining funds are deposited in the Maryland Agricultural Lands Preservation Fund.<sup>80</sup> A county certified by the Maryland

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<sup>74</sup> Md. Code Ann. Tax-Property 13-209.

<sup>75</sup> Md. Code Ann. Tax-Property 13-302.

<sup>76</sup> Md. Code Ann. Tax-Property 8-209.

<sup>77</sup> Md. Code Ann. Tax-Property 13-303, 13-305(a).

<sup>78</sup> Md. Code Ann. Tax-Property 13-304, 13-305(b)(provided the parcel is no larger than the minimum parcel required by applicable zoning for residential housing).

<sup>79</sup> Md. Code Ann. Nat Res. 5-307. This program provides cost-share assistance to private landowners for tree planting, site preparation, and timber stand improvement practices. It covers up to 50 percent of the cost of eligible practices. Eligible landowners must have 10-500 acres of land suitable for forest products. Maryland distributes approximately \$100,000 to 75-100 landowners for management practices on 1500-2000 acres each year.

<sup>80</sup> Md. Code Ann. Agric. 2-506. Md. Code Ann. Tax-Property 13-306(a). HB935 (2003)

Department of Planning and MALPF as having an effective county agricultural lands preservation program remits the woodland funds, but only 25 percent of the remaining funds. Counties use their retained share of agricultural lands transfer funds for agricultural lands preservation. Unexpended balances revert to MALPF.<sup>81</sup>

State law also provides for fees for recording instruments in the land records. Fees are \$20 for deeds or other instruments regarding principal residences, \$20 for other instruments under 10 pages, and \$75 for instruments of 10 or more pages.<sup>82</sup>

### **Reductions, Exemptions, Deductions, Credits**

Transfers to counties, municipalities, the Maryland National Capital Park & Planning Commission, and the Washington Suburban Sanitary District are exempt from recordation fees and the state transfer tax.<sup>83</sup>

Transfers of conservation easements to co-ownership by a land trust and a governmental entity are exempt, as are fee simple transfers to a land trust if the land trust declares its intent to convey the land to a governmental entity within 18 months.<sup>84</sup>

Transfers of agricultural land to a nonprofit organization whose purpose is conserving agricultural land “for the purpose of maintaining the character of the land as agricultural land” are exempt from the state transfer tax.<sup>85</sup>

Agricultural land transfers are exempt from the agricultural land transfer tax if the transferee specifies that the land will remain in agricultural use for at least the next five years and applies for agricultural use assessment of the land.<sup>86</sup>

### **OTHER TAXES**

Maryland taxes sales of alcoholic beverages; rates include \$1.50/gal for distilled spirits,

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transfers \$18.8 million of the MALPF balance to the general fund for 2003.

<sup>81</sup> Md. Code Ann. Tax-Property 13-306(a-1), (B).

<sup>82</sup> Md. Code Ann. Real Property 3-601. Counties and Baltimore City also may impose recordation taxes at rates they prescribe; as well as county transfer taxes (discussed below).

<sup>83</sup> Md. Code Ann. Real Property 3-603, Tax-Property 13-207.

<sup>84</sup> SB112 (2003), amending Md. Code Ann. Tax-Property 13-207.

<sup>85</sup> Md. Code Ann. Tax-Property 13-207(b).

<sup>86</sup> Md. Code Ann. Tax-Property 13-305(c).

40 cents/gal for wine, 9 cents/gal for beer.<sup>87</sup> Maryland taxes cigarettes at a rate of 5 cents per cigarette (\$1 per pack).<sup>88</sup> A substantial portion of the cigarette tax funds state aid to education.

## **LOCAL TAXES**

### **REAL PROPERTY TAX**

Property is taxed by the 23 counties and Baltimore City, and may also be taxed by the 155 incorporated municipalities within counties. Property located within municipalities is subject to taxation by both the municipality and the county. Property taxes make up about 30 percent of county budgets.

The Maryland Constitution provides that “the General Assembly shall, by uniform rules, provide for the separate assessment, classification and sub-classification of land, improvements on land and personal property, as it may deem proper; and all taxes thereafter provided to be levied by the State for the support of the general State Government, and by the Counties and by the City of Baltimore for their respective purposes, shall be uniform within each class or subclass of land, improvements on land and personal property.”<sup>89</sup>

Assessments must be based on 100 percent of fair market value (except for use value assessments described below). Assessments are conducted every three years. However, when assessments rise, the effect of the new appraisal must be phased in over three years.<sup>90</sup> There are no state limitations on tax rates, but there are limitations on annual assessment increases on homeowners.<sup>91</sup> Property tax rates vary from \$0.73 per \$100 of assessed value in Worcester County, to \$2.32 per \$100 in Baltimore City.

Special taxing districts of various kinds may levy property taxes, primarily to support public infrastructure construction, such as stormwater facilities, public lighting, parks. The tax is used to service bonded indebtedness on the infrastructure. In general, a district must be created by the municipal body upon petition by 2/3 of the district owners/total value within the proposed district. Special taxing districts are authorized in eight counties and all incorporated

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<sup>87</sup> Md. Code Ann. Tax-General 5-105.

<sup>88</sup> Md. Code Ann. Tax-General 12-105.

<sup>89</sup> Md. Const., Declaration of Rights, Art. 15.

<sup>90</sup> Md. Code Ann. Tax-Property 8-104. Department of Assessment and Taxation, A Homeowner’s Guide to Property Taxes and Assessments.

<sup>91</sup> Md. Code Ann. Tax-Property 9-105.

municipalities.<sup>92</sup> Some counties, including Montgomery and Frederick, have adopted their own versions of special taxing districts under separate authority.

### **Reductions, Exemptions, Deductions, Credits**

State law exempts government-owned, educational, and religious property from taxation; and provides for applications for exemptions by blind homeowners and their surviving spouses, churches and associated property, community association property, disabled veterans and their surviving spouses, surviving spouse of military casualties, fraternal or benevolent or educational facilities, and charitable facilities. There is a substantial list of general exemptions in state law.<sup>93</sup>

Maryland's Homestead Tax Credit is automatically applied by the taxing body to limit taxes if the assessment of an owner-occupied principal residence increases more than a specified percentage over the previous year. State law requires that county and municipal governments set their own percentage for application of the credit, capping the annual increase to between 0-10 percent.<sup>94</sup> This means that taxes on owner-occupied homes that have increased in value are typically less than they would be without the credit. (Typical local percentages are 0%, 2%, 4%, 5%, 7%). Towns and counties that limit the appraisal increase to 0% (e.g. Talbot County) have essentially frozen the assessments for current owner-occupants. Thus, owner-occupied homes bear less of a tax rate burden than commercial and industrial properties and rental properties in many jurisdictions.

A separate state-mandated Homeowner's Tax Credit program provides a tax credit for homeowners that are on lower incomes. It is intended to help those with a high property tax liability compared to gross household income. The average credit in FY2002 was \$751, awarded to 60,000 Maryland homeowners, out of 79,000 applicants. The state reimburses the county for the credit granted.<sup>95</sup> A similar Renter's Tax Credit program provides relief to renters (assuming that taxes are about 15 percent of rent), and provided average credits of \$276 to 12,800 renters.<sup>96</sup> Counties or municipalities may supplement these credits, but do not receive reimbursements for any supplements.<sup>97</sup>

Homeowners age 65 and older may defer an increase in their property tax bills under

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<sup>92</sup> Md. Code Ann. Art. 23A sec. 44; Art. 24 sec. 9-1301.

<sup>93</sup> Md. Code Ann. Tax-Property 7-201 through 7-241.

<sup>94</sup> Md. Code Ann. Tax-Property 9-105. The percentage limit is applied *after* the three-year phase-in of reassessments is taken into account.

<sup>95</sup> Md. Code Ann. Tax-Property 9-104.

<sup>96</sup> Md. Code Ann. Tax-Property 9-102.

<sup>97</sup> Md. Code Ann. Tax-Property 9-215, -215.1.

county or municipal laws (Montgomery County has a deferral program for certain lower income homeowners under age 65); the deferred tax becomes a lien on the property, which is recouped upon sale.<sup>98</sup>

### *Conservation and Land Management*

There are statutory exemptions from property taxes for nonprofit burial grounds, for property owned by various conservation organizations such as the Chesapeake Bay Foundation and the Nature Conservancy, and for property held by charitable or educational organizations; however, not more than 100 acres of such property appurtenant to the premises in this last category is exempt if the property is outside a municipal corporation or Baltimore City.<sup>99</sup>

Land may be assessed at its “use value” rather than fair market value under several programs, resulting in lower taxation for these open space lands. Maryland law authorizes county assessors to assess farm and forest land “actively used for farm or agricultural use” at the land’s use value rather than at fair market value.<sup>100</sup> The criteria to determine that land is actively used for agriculture include “the productivity of the land, including timberlands and reforested lands,” as well as the income generated from the land, the present use of the land, and zoning of the land.<sup>101</sup> If the parcel is under 20 acres or not zoned for agricultural use, the owner must affirm that the agricultural use of the land produces at least \$2,500 per year unless certain findings are made to excuse lack of revenue (such as drought, newness of the operation, or old age of the owner). Parcels of woodland of less than 5 acres (excluding the homesite) are not eligible.<sup>102</sup> For forest land, the owner must have a forest management plan (FMP) prepared by any state-licensed registered forester.<sup>103</sup> Forest land is assessed at the agricultural rate for woodland. Marshland is valued at 50% of the highest value for “Class E” farmland use value under the program.<sup>104</sup> This use value assessment program does not trigger a tax recapture if the

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<sup>98</sup> Department of Assessments and Taxation, A Homeowner’s Guide to Property Taxes and Assessments. Md. Code Ann. Tax-Property 10-204. Some counties may offer deferrals to any homeowner based on increases resulting from rezoning. 10-201.

<sup>99</sup> Md. Code Ann. Tax-Property 7-201 (burial grounds), 7-203 (CBF), 7-218 (TNC), 7-202(c) (charitable or education proviso).

<sup>100</sup> Md. Code Ann. Tax-Property 8-209.

<sup>101</sup> Md. Code Ann., Tax-Property §8-209(e)(2)(iii).

<sup>102</sup> Md. Code Ann., Tax-Property §8-209(h)(v).

<sup>103</sup> The plan must be filed in the county assessor’s office. Landowners pay licensed foresters for plan development, and may be required to pay for inspections if required by the county assessor, but do not pay fees for enrollment in the program.

<sup>104</sup> Md. Code Ann. Tax-Property 8-210.



land use is changed, but does trigger the Maryland agricultural lands transfer tax upon conveyance and conversion to a non-agricultural/forest use.

Maryland also offers a separate program for reduced assessment for forest land owners under the Forest Conservation Management Program.<sup>105</sup> The law allows owners of five or more contiguous acres of forest land to apply for a reduced or frozen property tax assessment by entering into an agreement with the Department of Natural Resources (DNR) not to develop the land for nonforest uses. The agreement, which has a minimum term of 15 years, is recorded in the county land records. Under this program, property assessments for state and local tax purposes are frozen at \$125/acre for the life of the agreement, which may be renewed for another 15 years at the option of the landowner. A “forest conservation and management plan” is required. Forest harvests are allowed when conducted in accordance with the plan. The Department of Natural Resources assesses fees for entering the program, developing the plan, and conducting inspections. If the property is conveyed to another person, the value is reassessed and back taxes are due (reflecting the difference between the amount paid and the amount that would have been paid absent the reduced assessment), unless the new owner assumes the obligation of the recorded agreement. A penalty of \$100 is also due to DNR. The reassessment applies only to the portion conveyed or harvested. Back taxes must also be paid if the owner conducts harvests that violate the management agreement or converts the land to non-forest uses. However, the law allows a landowner with more than 50 contiguous acres to convey a one-acre building lot to the owner’s child for construction of a dwelling without incurring back taxes. Conversions due to eminent domain are not subject to penalty or back taxes.

Land subject to conservation easements that “limit use of the land to preserve the natural open character of the land” must be assessed with respect to the limitation of the easement.<sup>106</sup> This provision assures that lands subject to conservation easements are not assessed as though they were subject to development.

Country clubs and golf courses may qualify for open space assessments at other than fair market value subject to conditions.<sup>107</sup>

Maryland requires county and municipal governments to apply a fifteen-year 100 percent property tax credit against all real property taxes on “conservation property,” defined as unimproved land not used for a commercial purpose that is subject to a perpetual conservation easement donated to the Maryland Environmental Trust.<sup>108</sup>

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<sup>105</sup> Md. Code Ann. Tax-Property 8-211.

<sup>106</sup> Md. Code Ann. Tax-Property 8-219.

<sup>107</sup> Md. Code Ann. Tax-Property 8-212 to -218.

<sup>108</sup> Md. Code Ann. Tax-Property 9-107.

Counties may grant a property tax credit for “open space” recognized as such by the county, determined as such under state law, or subject to a perpetual conservation easement held by a governmental unit. The tax credit is up to 75 percent in Baltimore City and most counties; and up to 100 percent in 9 counties. Other counties, including Baltimore City may grant up to 100 percent if the land is subject to an option agreement for sale in fee simple w/in 20 years for open space.<sup>109</sup>

County and municipal governments are authorized to offer credits against property taxes on lands and easements held by nonprofit land trusts.<sup>110</sup> County and municipal governments are also authorized to offer credits to specific named conservation organizations on lands they own for wildlife protection, environmental education, or public natural area use.<sup>111</sup>

Counties may grant a property tax credit up to 75 percent to agricultural land subject to an *easement* permanently conveyed to the Maryland Agricultural Land Preservation Foundation.<sup>112</sup> Specific provisions also authorize counties to give property tax credits for land enrolled in an agricultural preservation district.<sup>113</sup>

A county may grant a property tax credit of up to 50 percent of the tax due for agricultural land that is subject to a current soil conservation and water quality plan approved by the county soil conservation district, and a nutrient management plan where required. Violation of the plan that is unremedied within one year results in penalty of double the taxes that would have been owed, from the date of the notice of violation.<sup>114</sup>

Maryland law authorizes Dorchester County to grant a property tax credit for “forest land that is subject to a forest management plan or similar agreement.” This provision allows that county to develop its own program with different qualifications and conditions from those under

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<sup>109</sup> Md. Code Ann. Tax-Property 9-208. The state law allows Montgomery and Prince George’s County to apply the credit to open space land on which easements are 5 years or longer.

<sup>110</sup> Md. Code Ann. Tax-Property 9-220.

<sup>111</sup> E.g. Md. Code Ann. Tax-Property 9-233 (“Audubon Naturalist Society”)

<sup>112</sup> Md. Code Ann. Tax-Property 9-206.

<sup>113</sup> E.g., Md. Code Ann. Tax-Property § 9-306 (Calvert County), § 9-307 (Caroline County), § 9-310 (Charles County), § 9-314 (Harford County). The landowners sign a voluntary agreement that the land will be maintained in agricultural use for a minimum of five years (or other requirements). The agreement further states that the land will not be subdivided for residential, commercial or industrial use while under district status.

<sup>114</sup> Md. Code Ann. Tax-Property 9-226.

the preferential use value assessment programs.<sup>115</sup>

### *Community Revitalization and Reinvestment*

Counties are authorized to enact property tax exemptions, some of which are subject to payments in lieu of taxes agreements for some services. These include, among others, low income housing and service facilities owned by a nonprofit housing corporation or housing authority, and government-subsidized low income housing; and in Baltimore City vacant and underutilized buildings in the downtown management district, and a major economic development project creating new jobs and capital investments in an urban renewal area.<sup>116</sup>

Counties and municipalities may grant a property tax credit equal to 10 percent of documented expenses of a private owner to restore and preserve a structure of historic or architectural value; and up to 5 percent for construction of architecturally compatible new structures in a historic district.<sup>117</sup>

Counties and municipalities may also implement a property tax credit not to exceed the difference between the property tax payable before and after restoration/rehabilitation improvements of a historic structure, for a period not to exceed 10 years.<sup>118</sup>

Counties and municipalities may grant a property tax credit that they define for vacant or underutilized commercial, industrial, or office building that “is renovated for use primarily as housing,” and may provide for payment in lieu of taxes.<sup>119</sup>

Counties and municipalities may grant property tax credit for rehabilitation of real property, not to exceed the incremental increase in tax attributable to the rehabilitation and for a period not to exceed 10 years.<sup>120</sup>

Various special credit authorizations are authorized for individual Maryland counties and Baltimore City.<sup>121</sup> For example, Baltimore City may grant a property tax credit for qualified new

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<sup>115</sup> Md. Code Ann. Tax-Property 9-311(f)(1)(ii).

<sup>116</sup> Md. Code Ann. Tax-Property 7-503, 7-504, 7-506 to -506.2; and 7-504.2, -504.3 (Baltimore).

<sup>117</sup> Md. Code Ann. Tax-Property 9-204.

<sup>118</sup> Md. Code Ann. Tax-Property 9-204.1.

<sup>119</sup> Md. Code Ann. Tax-Property 9-234.

<sup>120</sup> Md. Code Ann. Tax-Property 9-236.

<sup>121</sup> Md. Code Ann. Tax-Property 9-301 to -326.

owners of vacant dwellings containing 1-4 units that are vacant, in violation of codes, owned by the city for one year, and in need of repair. The credit is on the incremental value added by the rehabilitation of the property, in an amount of 100 percent of the increment in the first year declining by 20 percent each year for five years. A similar credit is authorized for newly constructed dwellings owned by qualifying owners (from 50 percent declining over 5 years); this one expires June 30, 2005. Another credit is authorized for substantial improvements by a homeowner resulting in increased assessments; the credit is 100 percent of the increase declining by 20 percent each year for 5 years, but does not apply to the value of improvements over \$100,000. Finally, state law authorizes Baltimore to adopt a credit for newly constructed market-rate rental housing projects of five or more units (50 percent declining over 5 years), but no new properties qualify after June 2001.<sup>122</sup>

Baltimore City, Baltimore County, Prince George's County, and Montgomery County may offer a neighborhood stabilization property tax credit of 40 percent declining over ten years to stimulate home ownership in residential property in designated neighborhoods. This credit is matched by a corresponding state income tax credit.<sup>123</sup>

Maryland counties and municipal governments may create "development districts" within which infrastructure and public improvements may be funded by bonds supported by tax increment financing.<sup>124</sup>

Maryland requires county and municipal governments to apply an enterprise zone tax credit against property taxes for business property located within such zones. The credit is 80 percent of the tax amount resulting from the increased assessment resulting from the investment for the first five years, declining from 70 percent to 30 percent over the next five years before expiring. The state reimburses local government for one-half the foregone revenue.<sup>125</sup>

#### *General Job Creation/Industrial Benefit*

Counties and municipalities may grant a property tax credit of up to 100 percent for a period of years they may determine for new location, expansion or new production at manufacturing, fabricating or assembly facilities.<sup>126</sup>

Counties and municipalities may offer a property tax credit for job creation of 25 new

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<sup>122</sup> Md. Code Ann. Tax-Property 9-304(c)-(f).

<sup>123</sup> Md. Code Ann. Tax-Property 9-317(e), -318(d), -326.

<sup>124</sup> Md. Code Ann. Art. 41, 14-201 - 214.

<sup>125</sup> Md. Code Ann. Tax-Property 9-103.

<sup>126</sup> Md. Code Ann. Tax-Property 9-205.

jobs, or an enhanced credit for creation of 500 jobs. The credit is equal to a portion of the amount of property tax on the new or expanded premises, declining from 52 percent in the first year to 0 in the seventh and following years. The credit is supplemented by a state income tax credit.<sup>127</sup> The new or expanded premises must be in a priority funding area.<sup>128</sup>

### *Other Tax Breaks*

Maryland offers a reduced assessment for certain “planned development land.” in order to facilitate land assembly and to permit holding of land “for orderly and staged improvement, particularly for the development of new communities.”<sup>129</sup> Under this 1985 law, the land must be located in an area designated for development in a master plan that requires the owner to pay for public facilities ordinarily provided by counties and municipalities (schools, streets, parks, etc), and be not less than 500 acres. The land is assessed at the agricultural use rate, until subdivided or improved.<sup>130</sup>

Certain designated structures are not assessed. A manure bank used for storage of animal wastes is not assessed as an improvement, nor is a silo for farm storage of animal feed.<sup>131</sup>

“A seawall, bulkhead, or other structure installed solely to prevent shore erosion or damage by wave action of any body of water may not be assessed as an improvement, unless the seawall, bulkhead, or other structure is part of another improvement.”<sup>132</sup>

Solar heating and cooling systems shall not be assessed at more than the value of a conventional system; and buildings with both solar and conventional systems shall not be assessed at more than the value afforded by the conventional system alone.<sup>133</sup>

A homeowner may receive a reduced assessment if the home has a failing or defective

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<sup>127</sup> Md. Code Ann. Tax-Property 9-230.

<sup>128</sup> Md. Code Ann. Tax-Property 9-230(b)(4).

<sup>129</sup> Md. Code Ann. Tax-Property 8-220.

<sup>130</sup> Md. Code Ann. Tax-Property 8-222. (If part of the land is rezoned at the owner’s request and is no longer a planned development, then deferred back taxes are owed. 8-224.) Prince George’s County is also authorized to grant a deferral of increased taxes for commercial and industrial land under a staged development rezoning classification. Md Code Ann. Tax-Property 10-202.

<sup>131</sup> Md. Code Ann. Tax-Property 8-232, 8-239.

<sup>132</sup> Md. Code Ann. Tax-Property 8-238 (1985 law).

<sup>133</sup> Md. Code Ann. Tax-Property 8-240.

septic system or well, if the owner notifies the county and the deficiency affects the property value.<sup>134</sup>

Counties and municipalities may grant a credit in any amount or duration for the “erection or placement of bulkheads, groins, or other erosion control devices; measures required to stabilize waterside, shorelines, and banks; and measures required to change drainage patterns” and may define eligible “erosion control structures, devices, and procedures qualifying for the credit.”<sup>135</sup>

Counties and municipalities may grant a credit in any amount or duration for the tax imposed on real property with a sediment control pond or stormwater management structure required by law.<sup>136</sup>

Counties and municipalities may grant a property tax credit for diminished value of residential property damaged by flooding or sewage damage caused by flood conditions.<sup>137</sup>

County and municipal governments are authorized to grant a property tax credit to homeowners to offset in whole or in part increases in income tax revenues resulting from a county income tax rate exceeding 2.6 percent.<sup>138</sup>

Counties and municipalities may grant a property tax credit of up to 100 percent for newly constructed or substantially rehabilitated unsold dwellings for not more than the unsold period, but not to exceed one year.<sup>139</sup>

## **PERSONAL PROPERTY TAX**

Maryland businesses pay an annual tax to counties and municipalities based on the value of personal property.<sup>140</sup> Intangible personal property is not taxed.<sup>141</sup> The Department of Assessments and Taxation manages the assessment and valuation process; the tax is levied and

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<sup>134</sup> Md. Code Ann. Tax-Property 8-237.

<sup>135</sup> Md. Code Ann. Tax-Property 9-217.

<sup>136</sup> Md. Code Ann. Tax-Property 9-224.

<sup>137</sup> Md. Code Ann. Tax-Property 9-211.

<sup>138</sup> Md. Code Ann. Tax-Property 9-221.

<sup>139</sup> Md. Code Ann. Tax-Property 9-207 (Counties/municipalities), 9-401 (Balt. City).

<sup>140</sup> Md. Code Ann. Tax-Property 6-104.

<sup>141</sup> Md. Code Ann. Tax-Property 6-101.

collected by the counties and municipalities. Frederick, Kent, Queen Anne's and Talbot Counties do not tax personal property. Counties and municipalities imposing a tax on personal property and "operating real property of a public utility" must do so at 2.5 times the rate applied to real property.<sup>142</sup> In recent years, county tax rates averaged around 3 percent, and municipalities about 1 percent of assessed value.

### **Reductions, Exemptions, Deductions, Credits**

There is a substantial list of general exemptions in state law, corresponding to the exemptions for real property. Manufacturing personal property (except in certain counties), business inventory, farm implements and livestock, raw materials, pollution control facilities, and the like are exempt.<sup>143</sup> However, business inventory, manufacturing property, and raw materials may be taxed by municipal corporations.<sup>144</sup> Counties and municipalities may also exempt various classes of personal property from assessment and taxation. Most Maryland counties and many Maryland municipalities exempt commercial inventory, manufacturing/R&D inventory, and manufacturing/R&D machinery.<sup>145</sup>

### **LOCAL TRANSFER TAXES AND RECORDING FEES**

Maryland's recordation tax is levied by the counties and Baltimore City at a rate they determine.<sup>146</sup> The recordation tax is paid to the county general fund.<sup>147</sup>

Counties may adopt a transfer tax, subject to limitations.<sup>148</sup> Home rule counties may

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<sup>142</sup> Md. Code Ann. Tax-Property 6-302, 6-303.

<sup>143</sup> Md. Code Ann. Tax-Property 7-201 through 7-241.

<sup>144</sup> Md. Code Ann. Tax-Property 7-109.

<sup>145</sup> <http://www.dat.state.md.us/sdatweb/02exempt.html>.

<sup>146</sup> Md. Code Ann. Tax-Property 12-103.

<sup>147</sup> Md. Code Ann. Tax-Property 12-110. However, \$2.20 of the Harford County recordation tax goes to the special school fund, and 55 cents to the open space and recreation fund. 12-113.

<sup>148</sup> Md. Code Ann. Tax-Property 13-402. County transfer taxes on agricultural lands may not exceed the rate applicable to improved lands, and if such taxes enacted prior to July 1, 1979 did so, they must be adjusted so as not to exceed 5 percent plus the rate that applies to improved residential land; new or increased transfer taxes on lands subject to the state agricultural lands transfer tax may not be imposed after July 1, 1979. Md. Code Ann. Tax-Property 13-407.

impose such a tax, not to exceed 0.5 percent.<sup>149</sup> Washington County is authorized to impose an additional agricultural lands transfer tax of up to 2 percent, for use in purchase of agricultural lands development rights.<sup>150</sup>

### **Reductions, Exemptions, Deductions, Credits**

Counties may exempt from the county recordation tax or county transfer tax a specified amount paid for owner-occupied property acquired for a principal residence.<sup>151</sup> Counties may also entirely exempt first-time home buyers from these taxes.<sup>152</sup>

Governmental units acquiring property, transfers between spouses and former spouses, and refinancing for the same amounts are exempt from the recordation tax.<sup>153</sup> County transfer taxes have the same exemptions as state transfer taxes.<sup>154</sup>

### **LOCAL INCOME TAXES**

Counties are required to tax income at rates of 1 percent but not to exceed 3.2 percent.<sup>155</sup> Local income taxes established by the counties ranged from 1.25 percent to 3.1 percent in 2001.<sup>156</sup> Taxes are based on the state adjusted gross income and are collected by the Comptroller as a convenience to counties. Maryland offers a low-income tax credit against county income taxes for low income taxpayers below the poverty line, as well as an earned income tax credit.

### **LOCAL OCCUPATION AND BUSINESS TAXES**

In addition to the business personal property tax, described above, municipalities may require local business licenses.

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<sup>149</sup> Md. Code Ann. Tax-Property 13-402.1.

<sup>150</sup> Md. Code Ann. Tax-Property 13-502, 13-503.

<sup>151</sup> Md. Code Ann. Tax-Property 12-103, 13-408.

<sup>152</sup> Md. Code Ann. Tax-Property 12-103, 13-409.

<sup>153</sup> Md. Code Ann. Tax-Property 12-108..

<sup>154</sup> Md. Code Ann. Tax-Property 13-402.1(b)(2).

<sup>155</sup> Md. Code Ann. Tax-General 10-106.

<sup>156</sup> <http://individuals.marylandtaxes.com/incometax/localtax.asp>.



## LOCAL SALES AND USE TAXES

Local governments may not levy a sales and use tax, unless in effect on January 1, 1971, but may tax fuels, utilities, space rentals, and controlled substances.<sup>157</sup>

## TRAVEL/ENTERTAINMENT TAXES

Counties and municipalities may impose a tax on gross receipts from admissions and amusements.<sup>158</sup> However, counties may not impose the tax if the municipality does so, or if the municipality specifically exempts the admission/amusement from tax.<sup>159</sup> The tax may be imposed at a rate of up to 10 percent, and different rates may be set for different classes of admissions/amusements. Taxes may be imposed on free or reduced rate admissions in the amount of 5 cents (15 cents for tickets costing more than \$1).<sup>160</sup> Actual local rates vary from 0.5 percent up to 10 percent.

A code home rule county may impose food/beverage taxes of 1 percent to support a convention center.<sup>161</sup>

## IMPACT FEES

Impact fees are authorized for various counties and local governments.<sup>162</sup> For example, Prince George's County is authorized to assess a fee of \$5,000 per residential unit for applications filed after July 1, 2000. Impact fees must bear some rational relationship to the costs imposed on the community by the developments upon which they are charged. Recently impact fees have been rising in rapidly growing counties authorized to assess them (Carroll County raised its single family detached housing impact fee from \$4,744 to \$6,836 effective July 1, 2003, and it set its townhouse impact fee even higher, evidently in order to offset the perceived revenue loss from townhouses, which tend to generate lower real property taxes than detached residences, while demanding similar levels of services)..

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<sup>157</sup> Md. Code Ann. Tax-General 11-102.

<sup>158</sup> Md. Code Ann. Tax-General 4-102.

<sup>159</sup> Md. Code Ann. Tax-General 4-103.

<sup>160</sup> Md. Code Ann. Tax-General 4-105.

<sup>161</sup> Md. Code Ann. Tax-General 11-102; Md. Code Ann. Art. 25B-Code Home Rule Counties 13H.

<sup>162</sup> E.g. Md. Code Ann. Art. 25- County Commissioners 9F (Carroll County impact fees), 9H (Garrett County impact fees), 9J (Frederick County impact fees); and Md. Code Ann. Art. 25B-Code Home Rule Counties 13D (development impact fees for public improvements "required to accommodate new construction or development.").

Municipalities are required to assist counties in the collection of impact fees for school construction levied on residential construction within the municipality.<sup>163</sup>

Code home rule counties are authorized to levy an excise tax on residential development, at an amount not to exceed \$750 per lot to support purchase of development rights for agricultural preservation.<sup>164</sup> Calvert County is authorized to levy an excise tax on building construction.<sup>165</sup>

### **MARYLAND TAX SUMMARY**

Maryland has a relatively balanced system of taxation which reaches a multiplicity of subjects, but does not disproportionately rely on any one source. A recent study shows that, considering all state and local taxes together, property taxes in Maryland account for 25 percent of tax revenues, personal income taxes for 39.6 percent of tax revenues, the corporate income tax for 2.4 percent of tax revenues, sales and fuels and excise taxes 25.8 percent of tax revenues, license fees 2.3 percent of tax revenues, and other taxes 4.8 percent of tax revenues. State government is funded primarily by the state income tax and the sales and use tax, which in fiscal 2003 made up 48 percent and 26 percent of general fund revenues, respectively. These are followed in importance by business taxes, lottery proceeds, and various other taxes. The general fund accounts for about one-half of total state budget revenues. The remainder are the transportation trust fund, higher education accounts, various other dedicated funds, and federal funds. Local governments derive 30-35 percent of their revenues from property taxes, followed by local income taxes, state funds to localities, and certain other local taxes. The property tax has the greatest impact on local land use decisions, although its effect is less than in some other states because of the importance of local income taxes.

Source: Maryland Department of Legislative Services, "Revenue and Expenditure Comparisons for Maryland and Selected States," "Maryland's Fiscal Structure and General Fund Outlook," August 8, 2002.

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<sup>163</sup> Md. Code Ann. Corporations-Municipal 8C.

<sup>164</sup> Md. Code Ann. Art.- Code Home Rule Counties 13G.

<sup>165</sup> Md. Code Ann. Art. 25 - County Commissioners 9G.

## CHAPTER THREE - PENNSYLVANIA TAXES

At the state level, Pennsylvania taxes individual and corporate net income, corporate worth, financial and insurance companies, certain public utility property, inheritances and estates, sales and use, hotel occupancy, fuels, vehicle rentals, real estate transfers, and cigarettes and alcohol, among other subjects. Most state taxes are collected by the Department of Revenue.

Pennsylvania state laws define the taxing powers of local governments, using a complex municipal classification system to assign these powers to different kinds of defined municipal entities. There are no “unincorporated areas” in Pennsylvania counties, so every resident is within a local taxing municipality as well as within a county. Pennsylvania has 2,566 units of local municipal government with local taxing authority. These include one first class city (Philadelphia), one second class city (Pittsburgh), one second class A city (Scranton), 53 third class cities, 961 boroughs, 91 first class townships, 1,457 second class townships, and one town.<sup>166</sup> Pennsylvania’s 501 school districts have their own taxing powers and are responsible for raising their own revenues through taxation. The Commonwealth’s 67 counties also have some taxing authority, but except for Philadelphia and Allegheny (the first and second class counties), this authority is limited, as are the governance powers of counties. Municipal governments, counties, and school districts are all authorized to tax real property. Municipalities and school districts may also tax earned income. Other local taxes include per capita taxes, occupation taxes, occupational privilege taxes, business gross receipts taxes, real property transfer taxes, and amusement and admission taxes, as well as a number of special taxes.

Pennsylvania’s constitution requires that “all taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws.”<sup>167</sup>

In addition to local governments, school districts, and counties, Pennsylvania also has more than 2000 “municipal authorities” of various kinds – redevelopment authorities, parking authorities, water and sewer authorities, general authorities, etc. These authorities are entitled to incur debt, and they impose fees and charges for infrastructure or services that might otherwise be tax-funded if performed by a unit of local government. Thus, in at least a functional sense municipal authorities are also part of the local “taxing” structure. (Municipal authorities may receive tax proceeds where they perform a service or provide infrastructure to a municipality or school district).

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<sup>166</sup> Governor’s Center for Local Government Services, fact sheet (2002).

<sup>167</sup> Pa. Const. Art. VIII, Sec. 1.

## STATE TAXES

### STATE INCOME TAXES

Pennsylvania levies a tax on personal income at a flat rate of 2.8 percent. A flat rate has been required based on interpretation of the Pennsylvania constitutional provision that taxes be “uniform upon the same class of subjects.” Pennsylvania taxes gross compensation and does not provide for exemptions, deductions, or exclusions. However, retirement and pension income is not taxed.<sup>168</sup> Ordinary, necessary, and reasonable business expenses are deductible in determining net income from a business.

Pennsylvania levies a corporate net income tax at a flat rate of 9.99 percent.<sup>169</sup> Calculating the portion of corporate net income attributable to Pennsylvania is done by a formula that weights sales at 60 percent, and in-state payroll and property at 40%.

#### **Reductions, Exemptions, Deductions, Credits**

For individual income, Pennsylvania taxes gross compensation and does not provide exemptions or deductions. However, since 1974, a credit has been available to low income taxpayers, who are eligible for tax forgiveness under a special program to assist poor working individuals and families. The eligibility income is \$6500 per individual claimant (\$13,000 for married couples), and \$9,000 per dependent. Under these provisions, a family of four earning \$31,000 in 2002 would have its Pennsylvania personal income tax of \$868 entirely forgiven. There is a sliding scale of partial forgiveness above this threshold; for example, a family of four earning \$33,250 would have ten percent of its tax forgiven.<sup>170</sup>

For corporations, Pennsylvania offers a number of tax credit programs that apply against the corporate net income tax, as well as against the Capital Stock and Franchise Tax, and state business taxes relevant to financial institutions, insurers, and utilities (discussed below). In general, tax credits do not apply to the individual income tax, except for the research and development and job creation tax credits.

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<sup>168</sup> 72 P.S. 7301-7361.

<sup>169</sup> 72 P.S. 7401-7412. This is one of the higher state corporate tax rates. See Pennsylvania Economy League, *A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States* (June 2001).

<sup>170</sup> <http://www.revenue.state.pa.us/revenue/taxonomy/taxonomy.asp?DLN=689>. These are not “personal exemptions” or “standard deductions” available to all taxpayers, but rather are income thresholds for full or partial tax forgiveness – intended to favor the working poor.

### *Community Revitalization and Reinvestment*

The Neighborhood Assistance Program authorizes credit against corporate income or other corporate taxes for projects in impoverished areas or qualified investments in designated enterprise zones, of up to 70% and 30% respectively, capped at \$250,000 per taxpayer annually. There is an additional credit of 70% (capped at \$350,000) for qualified investments in Comprehensive Service Projects. The credits may be carried forward for five years. The total statewide credits/year are capped at \$18 million.<sup>171</sup>

The Keystone Opportunity Zone program, discussed below, exempts all zone-generated income from taxation.<sup>172</sup> It provides exemptions from virtually all taxes in certain areas where reinvestment, jobs, and economic revitalization are needed. These benefits accrue to investors and businesses locating and operating in the KOZs.<sup>173</sup>

### *Job Creation and Investment*

The Job Creation Tax Credit provides that an employer entering into an agreement with the Department of Community and Economic Development creating at least 25 new full-time equivalent jobs or increasing its workforce by 20% or more within three years may receive tax credit of \$1,000 per job created. Twenty-five percent of tax credits must be allocated to firms with fewer than 100 employees. Annual credits statewide are \$22.5 million.<sup>174</sup>

The Employment Incentive Payments Program provides a welfare-to-work tax credit in first three years of employment for a portion of the wages of an employee. Capped at \$25 million/year statewide, the credit is available for employees hired prior to Dec. 31, 2004.

Research & Development Tax Credits are offered for research investments in Pennsylvania. The credit is 10% of the increase in activities over a base period (but the credit may not exceed 50% of the taxpayer's total tax liability), and may be carried forward for 15 years. It is capped statewide at \$15 million/year with \$3 million allocated for small businesses. The credit has been extended until 2006.<sup>175</sup>

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<sup>171</sup> 72 P.S. 8901-A - 8906-A.

<sup>172</sup> 53 P.S. 820.101. The program is discussed under Local Real Property Taxes.

<sup>173</sup> 53 P.S. 820.101 et seq., as amended including SB 1478 (2002).

<sup>174</sup> 72 P.S. 8801-B et seq.

<sup>175</sup> Act 7 of 1997 as amended. The credit is based on research activities as defined under the federal research and development tax credit. 26 U.S.C. 41.

### *Energy Incentives*

There is a coal gasification tax credit for capital expenditures on facilities producing fuel from coal, culm or silt, capped at \$18 million/year statewide.

### **OTHER BUSINESS TAXES**

Pennsylvania levies a Capital Stock and Franchise Tax on corporate worth attributable to Pennsylvania (with an exclusion for the first \$125,000 of value). This tax is being eliminated. The rate (which in the early 1990s was as high as 13 percent) is 7.24 mills in 2002, and the tax rate is scheduled to decline by one mill annually until abolition of the tax in 2009.<sup>176</sup>

Pennsylvania taxes gross premiums of insurance companies at a rate of 2 percent.<sup>177</sup> The Commonwealth also taxes the value of shares of bank and trust companies and domestic title insurance companies at 1.25 percent, and the net income of mutual thrifts institutions at 11.5 percent.<sup>178</sup> Pennsylvania taxes corporate indebtedness (the corporate loan tax) at 4 mills, and taxes agricultural and electrical cooperatives in lieu of other corporate taxes.

Pennsylvania levies a 50 mill gross receipts tax on pipeline, conduit, steamboat, canal navigation and transportation, telephone and telegraph, electric light, water power and hydroelectric companies, express companies, palace car and sleeping car companies, and freight and oil transportation within the Commonwealth. The motor carrier gross receipts and railroad taxes were repealed; natural gas sales were exempted; and sales of electricity and telecommunications for resale were exempted. Small portions of the tax receipts (0.25 mills) are designated to support the alternative fuels incentive grant fund, and a small portion of the electric supplier gross receipts tax base is designated to the public transportation assistance fund.<sup>179</sup>

### **Reductions, Exemptions, Deductions, Credits**

Assets engaged in air and water pollution controls, specified processing operations, research and development, and computer software development, are exempt from the Capital Stock and Franchise tax. Nonprofit and family farm corporations are also exempt from the

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<sup>176</sup> 72 P.S. 7601 et seq. A small portion of the tax proceeds were dedicated to the Hazardous Sites Cleanup Fund, but that designation has been ended. The timing of the phase-out of the Capital Stock and Franchise Tax is threatened by current fiscal problems.

<sup>177</sup> 72 P.S. 7901-7906.

<sup>178</sup> 72 P.S. 7701-7706, 7801-7806, 8501-8506.

<sup>179</sup> 72 P.S. 8101-8103.

tax.<sup>180</sup>

The tax credit programs discussed under the Corporate Net Income Tax above apply to these other Pennsylvania business taxes. Businesses in Keystone Opportunity Zones are exempt from these taxes on their activities within the zones.

## **ESTATE AND INHERITANCE TAXES**

Pennsylvania has both an estate tax and an inheritance tax. The inheritance tax is levied on the value of the bequest at a rate of 0% between spouses and from minors to parents, 4.5% to lineal heirs, 12 % to siblings, and 15% to others. The tax is not levied on transfers to government entities, or to charitable or fraternal organizations when the bequest is used exclusively for religious, charitable, scientific, literary, or educational purposes, or on transfers to qualified veterans organizations.

The estate tax is a “pick-up” tax in the amount of the state tax credit allowed by federal estate tax laws before the 2001 federal tax act. The Pennsylvania estate tax equals the difference between the Pennsylvania inheritance tax (plus death taxes paid to other states) and the maximum federal tax credit allowed for state death taxes. Pennsylvania in 2001 decoupled its estate tax from federal estate tax law to avoid losing this source of revenue as the federal tax is phased out.<sup>181</sup>

## **STATE SALES AND USE TAXES**

Pennsylvania taxes retail sales, the consumption, rental or use of tangible property, and sales of certain related services at 6 percent.<sup>182</sup>

### **Reductions, Exemptions, Deductions, Credits**

The law exempts sales of food (other than by restaurants), medicine, clothing for every day wear, residential heating fuels, and sales for resale. It exempts maintenance of residential air conditioning. It exempts from sales tax used pre-built housing, and limits the taxable share of

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<sup>180</sup> The tax also had an exemption for manufacturing in Pennsylvania, but following a Pennsylvania Supreme Court ruling that the exemption violated interstate commerce constitutional provisions, the Department of Revenue in 2002 ended the manufacturing exemption entirely. Dept. of Revenue, “State Decides on Remedy for Manufacturing Exemption from Capital Stock & Franchise Tax,” May 1, 2002.

<sup>181</sup> Commonwealth of Pennsylvania Department of Revenue, *The Tax Compendium* (June 2001), p. 16, and updated. The federal estate tax is briefly discussed in Appendix A to this report.

<sup>182</sup> 72 P.S. 7201-7282.

new prebuilt housing to 60 percent of the manufacturer's price (or 100 percent of the manufacturer's materials cost).

The law exempts purchases by governmental units, volunteer fire companies, and purely public charities. It exempts purchases by and for manufacturing, processing, farming, dairying, agriculture, horticulture, floriculture, aquaculture, and public utilities.

Qualified businesses in Keystone Opportunity Zones are exempt from sales and use taxes on their purchases.

## VEHICLE FUEL TAXES

Under the Pennsylvania Constitution, proceeds from gasoline and motor fuel excise taxes, vehicle registration and licenses must be used "solely for construction, reconstruction, maintenance and repair of and safety on public highways and bridges and costs and expenses incident thereto...and shall not be diverted...to any other purpose."<sup>183</sup>

Pennsylvania has a Liquid Fuels and Fuels Tax which creates a permanent dedicated tax of 12 cents/gallon on liquid fuels; and a 2003 rate of 4.1 cents/gallon on aviation gasoline, and 1.8 cents on jet fuel (the latter two rates are adjusted annually). The Oil Company Franchise Tax (a wholesale tax remitted by distributors of fuels) in 2003 is 13.9 cents/gallon on liquid fuels and 30.8 cents/gallon on other fuels such as kerosene. Thus the total gasoline tax in 2003 is 25.9 cents/gallon.<sup>184</sup>

Like most states, the Commonwealth taxes motor carrier fuel consumption attributable to Pennsylvania. The Motor Carriers Road Tax/IFTA fuel taxes on "qualified motor vehicles (viz. fuel consumption by motor carriers within PA) is equivalent to current liquid fuels rate (12 cents/gal) plus an oil company franchise tax component, and a \$5 annual decal. Credit is granted for tax paid at pump or directly remitted."<sup>185</sup>

Pennsylvania has an alternative fuels tax on natural gas, compressed natural gas, liquid propane gas, liquified petroleum gas, alcohols, gas-alcohol mixtures with 85% alcohol, hydrogen, hythane, electricity, etc. These are converted to gasoline equivalents at 114,500 Btu, and taxed at the current liquid fuels rate and oil company franchise tax.

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<sup>183</sup> Pa. Const. Art. VIII, Sec. 11(a). A similar dedication applies to aviation fuel taxes, Sec. 11(b).

<sup>184</sup> 75 Pa. C.S. 9001 et seq. See Revenue Update No. 102, Nov-Dec. 2002. A bus company may apply for reimbursement of 55 mills of the fuel levy. Of the proceeds from the Franchise Tax, 57 mills are deposited in the motor license fund; and the remainder deposited to specific restricted accounts (e.g. bridges account).

<sup>185</sup> 75 Pa. C.S. 2101 et seq., 9601 et seq.



Because fuel and license taxes and fees can be used only for highways and bridges, funding to support public transportation and other modes must come from other sources. The Commonwealth has a Public Transportation Assistance Fund composed of fees and taxes with proceeds dedicated to mass transportation.<sup>186</sup> The fund consists of the proceeds from a statewide new tire fee - \$1 per tire; the Motor Vehicle Lease Tax - 3% of total lease price imposed in addition to the 6% sales tax on leases of more than 30 days (excluding trucks of class 4 and above); the Motor Vehicle Rental Fee - \$2 per day on vehicle rentals of less than 30 days; and the Public Utility Realty Additional Tax -7.6 mills on each dollar of state taxable value (see below). The Fund also receives 0.44% of sales and use taxes (equivalent to the tax on periodicals); and an additional 0.09% of sales and use taxes (to cover the exemption of class 4 trucks and above); it receives 0.18% of the gross receipts tax on electric suppliers; and it receives a supplemental Public Transportation Assistance Fund dedication of 1.22% of the sales and use tax (but not to exceed \$75 million in any year).

### **TRAVEL/ENTERTAINMENT TAXES**

Pennsylvania imposes the 6 percent state sales tax on hotel room rentals.<sup>187</sup>

Pennsylvania imposes a vehicle rental tax of 2 percent on leases of 29 days or less, which goes to the general fund after first refunding title/licensing fees of rental companies.<sup>188</sup> The Commonwealth also imposes a \$2/day rental fee on vehicle rentals of 30 days or more, which is dedicated to the Public Transportation Assistance Fund described above.

### **REAL PROPERTY AND PERSONAL PROPERTY TAXES**

The Commonwealth does not tax real property or personal property, except indirectly as part of corporate worth taxed under the corporate Capital Stock and Franchise Tax, and certain public utility real property which is taxed by the Commonwealth and distributed to local governments by formula. The Department of Revenue annually calculates the tax rate necessary to raise an amount of revenue necessary for the distribution; an additional 7.6 mills is assessed for the public transportation assistance fund.<sup>189</sup> However, real property used for electric power generation is now taxed locally. Sewage service public utilities and municipal authorities are exempt from the tax.

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<sup>186</sup> 72 P.S. 9301.

<sup>187</sup> 72 P.S. 7210.

<sup>188</sup> 72 P.S. 8601-A - 8604-A.

<sup>189</sup> 72 P.S. 8101-A et seq..

## STATE TRANSFER TAXES AND RECORDING FEES

The Commonwealth levies a real property transfer tax of one percent of the actual consideration paid (or fair market value if transaction was not at arms' length).<sup>190</sup> The tax also applies to executory construction contracts if a home lot is sold and a builder affiliated with the seller/developer contracts for construction on the lot. Fifteen percent of the transfer tax proceeds are earmarked for the Keystone Recreation, Park and Conservation Fund for service of the bond debt for this conservation and land acquisition program.

### Reductions, Exemptions, Deductions, Credits

Transfers exempt from the state transfer tax include transfers by will, mortgages, certain transfers among family members, transfers to governmental units, certain transfers among religious organizations, transfers to or from nonprofit industrial agencies, certain transfers of ownership interests in partnerships, corporations, real estate companies and family farms among owners, leases for production of fuels or minerals, and deeds to burial sites.

## OTHER TAXES

Pennsylvania levies an excise tax of 5 cents per cigarette (\$1.00 per pack), effective July 15, 2002.<sup>191</sup> The Agricultural Conservation Easement Purchase Fund will receive an annual transfer from Cigarette Tax receipts of \$20,485,000, and the Children's Health Insurance Program (CHIP) an annual transfer of \$30,730,000.

Pennsylvania levies a consumer tax on malt beverages with rates based on quantities (e.g. \$2.48/barrel, one cent/pint, etc).<sup>192</sup> The state Liquor Control Board handles taxation of liquor (liquor is taxed at a rate of 18 percent).<sup>193</sup>

In 2002, Pennsylvania enacted a \$4/ton waste fee for disposal of solid waste in Pennsylvania landfills. That fee is earmarked to support "Growing Greener" investments in Pennsylvania's environment. (Pennsylvania also has a "recycling fee" of \$2/ton on municipal waste that is disposed of in landfills, which supports recycling programs and grants).<sup>194</sup>

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<sup>190</sup> 72 P.S. 8101-C et seq. State law also authorizes municipalities and school districts to levy a one percent tax on transfers of real property (discussed below).

<sup>191</sup> 72 P.S. 8201-8297, as amended April 2002. Note that the state 6 percent sales tax also applies, and is calculated on the total price of the cigarettes including the excise tax.

<sup>192</sup> 72 P.S. 9009-9010.

<sup>193</sup> 47 P.S. 1-101 et seq, 794 et seq.

<sup>194</sup> Act 101-1988.

## LOCAL TAXES

Taxing powers are granted to specific units of government under the Commonwealth's numerous government codes spelling out the powers of counties, townships, boroughs, and cities, and by the Local Tax Enabling Act which further defines the taxing authorities of municipalities and most school districts. State enabling legislation for local taxes is very broad, but does not allow local taxation of natural resources, farm products, manufacturing, public utilities and their services, nonresident income by school districts, nor subjects upon which state taxes are levied (e.g. local sales taxes, cigarette taxes, etc.) unless specifically authorized.<sup>195</sup>

The state constitution requires the General Assembly to prescribe the debt limits of local governments (as a percentage of prior revenues), but excludes from the limits self-liquidating debt and debt approved by local referendum.<sup>196</sup> State legislation also imposes some limits on local tax rates, both as to real property taxes (discussed below), and a general cap on the aggregate of local taxes other than real property taxes.<sup>197</sup>

Local governments that engage in intergovernmental cooperative planning and implementation agreements with one another (or between a local government and a county government) are authorized to "provide by cooperative agreement for the sharing of tax revenues and fees."<sup>198</sup>

## REAL PROPERTY TAX.

Taxes on real property are levied by municipalities, school districts, and counties. The real property tax provides more than 50 percent of local municipal revenues, more than 90 percent of county revenues, and more than 85 percent of school district revenues.<sup>199</sup> Counties are responsible for the assessment of the value of real property for tax purposes. Land and improvements must be valued separately. Property must be assessed at its "actual value," which may be either the current value or a value derived from a base year with adjustments. In determining actual value, the county must consider cost (replacement less depreciation/obsolescence), comparable sales, and income approaches. The county is required to "equalize"

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<sup>195</sup> Local Tax Enabling Act, 53 P.S. 6901 et seq.

<sup>196</sup> Pa. Const. Art. IX, Sec. 10. Unit Debt Act, 53 P.S. 8001 et seq.

<sup>197</sup> The Local Tax Enabling Act limits the aggregate of local taxes (other than real property taxes) to no more than 12 mills times the market value of all real property within the taxing jurisdiction. 53 P.S. 6917(a).

<sup>198</sup> 53 Pa. Stat. Ann. 11105, MPC 1105.

<sup>199</sup> Governor's Center for Local Government Services, Taxation Manual (1999), p. 3.

assessments, and the actual sale price of a property is not controlling.<sup>200</sup> In practice, in many counties the “actual value” assessments deviate substantially from fair market value. After arriving at the “actual value,” the county then applies a predetermined ratio to determine the “assessed value.” This ratio may be set by the county at up to 100 percent (previously counties of the fourth-eighth class were limited to 75 percent). The predetermined ratio is also compared to a “common ratio” established by the State Tax Equalization Board.<sup>201</sup> In summary, assessed values are often a fraction of fair market value.

The tax rates are set separately by the local municipality, the school district, and the county. Except in Pittsburgh and Philadelphia, there are state statutory limits on real property tax rates. The limits on county real property tax rates are 25 mills<sup>202</sup> for counties of the second and third-eighth class, and 40 mills for second class A counties (Bucks, Delaware, and Montgomery)(raised in November 2002 from the previous 30 mills). In the Chesapeake Bay watershed, the counties are all subject to the 25 mill limit. Third class cities are limited to 25 mills, boroughs and first class townships to 30 mills, second class townships (where most services are provided by the counties) to 14 mills, and school districts (except Philadelphia and Pittsburgh) to 25 mills. Despite these limits, however, school districts can levy unlimited additional millage to pay for salaries and for debt service on school buildings (the major expenditures in most districts). Boroughs, townships, and third class cities can levy up to an additional five mills with local court approval.<sup>203</sup> Some additional millage can be levied for special purposes under special laws, including to support community colleges, to acquire open space (where authorized by local referendum), or by distressed communities. Most counties, municipalities and school districts must reduce the millage rate for the first year after a county-wide reappraisal of property so that taxes do not exceed 110 percent (105 percent in some

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<sup>200</sup> 72 P.S. 5020-402(a).

<sup>201</sup> See generally, Bert M. Goodman, *Assessment Law & Procedure in Pennsylvania* (2001).

<sup>202</sup> A “mill” is one-tenth of a cent. Thus, a 10 mill tax is a 1 percent tax on the assessed value of real property. However, because assessed value is less than fair market value, a 25 mill tax in Pennsylvania is not the same as a \$2.50 per \$100 value tax in Virginia where assessed values are supposed to be set at 100 percent of fair market value.

<sup>203</sup> See Governor’s Center for Local Government Services, *Taxation Manual* (1999), pp. 12, 67-77, and numerous acts including 2002 legislative session. Ceilings on millage rates have posed problems for some communities. A number of third class cities have needed to seek court approval for additional millage increases, as the loss of industrial and commercial tax base has added to the need for residential properties to carry the real property tax burden. Because of the separate exemption of school districts from millage caps for salaries and indebtedness, however, the caps do little to hold down the aggregate property tax burden.

counties) of the prior year tax receipts.<sup>204</sup>

Real property owned by public utilities was taxed by the Commonwealth rather than local governments, and distributed to local governments by formula.<sup>205</sup> However, land and improvements indispensable for generation of electric power are now assessed by the county and are taxed locally.

Real property tax rates must be uniform as between commercial and noncommercial property. However, certain urban municipalities may set different rates for buildings and land. These include Pittsburgh, Scranton, third class cities, third class school districts coterminous with third class cities, and boroughs (but not including farmland within boroughs).<sup>206</sup> This “split-rate” or “land value” taxation is used by a number of jurisdictions to tax land at a higher rate than buildings. This discourages urban land vacancy and inefficient use of valuable land for low-rise, low-quality buildings, while encouraging development, redevelopment and infill. Split-rate taxation was used in Pittsburgh from 1913-2001 and was credited with avoiding the “vacant lot” syndrome that has plagued many older cities, as well as encouraging investments. In 2001, after Allegheny County switched to a commercial firm for a wholesale reassessment of properties throughout the county leading to massive leaps in residential assessments, the Pittsburgh city council abolished the split rate in a move to smooth out tax bills for residents.<sup>207</sup> The system is still used in Harrisburg and several dozen municipalities across the Commonwealth.

Real property tax receipts support general local government and school functions. However such taxes may be levied for specific purposes under special laws. Pennsylvania law expressly authorizes a residents of a municipality to enact by referendum a real property tax which is designated to support acquisition and protection of open space tax.<sup>208</sup>

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<sup>204</sup> 72 P.S. 5020-402(b), 5453.602(b), 16 P.S. 4980.2.

<sup>205</sup> Pa. Const. Art. VIII, Sec. 4.

<sup>206</sup> 53 P.S. 25894, 53 P.S. 37531, 24 P.S. 6-672(e), 53 P.S. 46302.1.

<sup>207</sup> Dan Fitzpatrick, “New assessment structure packs a wallop for some Pittsburgh businesses,” Pittsburgh Post-Gazette, April 22, 2001 (explaining chain of events). The split rate was not abolished on policy grounds, but because the new appraisers were unable to satisfactorily assign values separately to land and buildings in a way that did not result in anomalous jumps in assessments felt primarily by homeowners. There is a substantial literature on the benefits of split-rate taxation for cities. See e.g., Alanna Hartzok, “Pennsylvania’s Success with Local Property Tax Reform: The Split Rate Tax,” Am. Journal of Econ. & Soc. (April 1997); <http://www.earthrights.net/docs/success.html>.

<sup>208</sup> 32 Pa. Stat. Ann. 5007.1 (authorizing either real estate tax or earned income tax for open space).

The Neighborhood Improvement Districts Act, enacted in 2000, allows municipalities to create special taxing districts for the purpose of promoting the economic and general welfare of the district and municipality. These districts collect special assessments, which are used for district purposes. Pittsburgh is using this law in a pilot program that guarantees a homeowner's equity after five years in order to encourage home ownership in blighted areas.<sup>209</sup>

### **Reductions, Exemptions, Deductions, Credits**

The Pennsylvania Constitution exempts from real property taxation residential property owned and occupied by certain veterans blinded or totally disabled in war and their surviving unmarried spouses, and authorizes the General Assembly to grant other exemptions.<sup>210</sup>

Statutory exemptions are churches and places of religious worship; not-for-profit cemeteries; nonprofit hospitals, institutions of learning or charity; government-owned schools; courthouses, jails, poorhouses; public parks; public property used for public purposes; property owned and used by veterans organizations for charitable, benevolent or patriotic purposes; real estate owned and used by institutions of purely public charity; playgrounds founded and maintained by public or private charity; charitable public libraries, museums, art galleries or concert halls; fire and rescue stations maintained by public or private charity including their social halls; and silos used for processing or storing animal feed on a farm.<sup>211</sup> Industrial equipment used in manufacturing is excluded from the definition of real property.<sup>212</sup>

State and federal real property is exempt from local real property taxation under principles of sovereign immunity.<sup>213</sup> However, local government-owned real property must qualify under one of the exemptions noted above. Municipal authorities (established for various purposes) are treated as agencies of the Commonwealth and are immune from taxation when acting within the scope of their mission.<sup>214</sup>

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<sup>209</sup> Act 130 (2000); see Janet Milkman, *Revitalizing Our Small Cities and Boroughs*, 10,000 Friends of Pennsylvania, 2002. It builds on prior "business improvement district" legislation. 53 Pa. C.S. 5401 et seq.

<sup>210</sup> Pa. Const. Art. VIII, Sec. 2(a), 2(c).

<sup>211</sup> 72 P.S. 5020-204, 5453.202.

<sup>212</sup> 72 P.S. 5020-201.

<sup>213</sup> Pennsylvania does make payments in lieu of taxes to local governments, counties, and school districts for state-owned forests, water conservation, flood control, and game lands, at 40 cents/acre. 72. P.S. 4303.

<sup>214</sup> Industrial development authorities, for example, are immune from local taxes, but may be required to have their tenants make payments in lieu of taxes for services received. 73 P.S. 385. Similarly, public housing authorities may by contract make contributions for municipal

The Pennsylvania Constitution authorizes the General Assembly to establish tax classifications that allow local taxing authorities to recognize age, disability, infirmity or poverty as a basis for offering exemptions or special tax provisions. The General Assembly can use this authority to grant exemptions from real property taxation on its own only where it “provides for the reimbursement of local taxing authorities” for the revenues lost.<sup>215</sup> All political subdivisions are authorized to establish tax deferral programs for low-income homeowners, applicable to increases in property taxes on the homestead over the year prior to the year of application; the deferred tax becomes a lien on the home.<sup>216</sup> Philadelphia, Allegheny County, and Pittsburgh (not in the Bay watershed) may rebate or forgive real estate tax increments resulting from rate increases or assessment increases owed by low-income senior citizens.<sup>217</sup> The Commonwealth also rebates local property taxes (and portions of rent representing property taxes) to senior citizens, widows/widowers, and permanently disabled persons, with income of less than \$15,000 on a sliding scale, with the maximum rebate limited to \$500.<sup>218</sup>

The Pennsylvania Constitution authorizes the General Assembly to authorize local taxing authorities to adopt a “homestead” exemption, which allows them to offer some property tax relief to homeowners without running afoul of the uniformity clause of the Pennsylvania Constitution. If adopted by a local taxing jurisdiction, the value of the exemption may not exceed 50 percent of the median value of all homestead properties in the jurisdiction. The exemption may not be offset by raising the local millage rate.<sup>219</sup> Some taxing entities (municipalities) may adopt it with respect to a given property while others (school districts, counties) may choose not to do so, or to set a different amount with respect to the same property. Farms that are the domicile of the owner may qualify for any additional farmstead exclusion (see below).<sup>220</sup> The homestead exemption is of a specific dollar amount of valuation – not a percentage reduction in valuation. Thus a jurisdiction that enacts a \$10,000 homestead exemption reduces the value of all homes by that amount for tax purposes. The homestead exemption is not in widespread use.

### *Conservation and Land Management*

The Pennsylvania Constitution authorizes the General Assembly to “establish standards  

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services at a rate of ten percent of annual rents (less utilities).

<sup>215</sup> Pa. Const. Art. VIII, Sec. 2(b)(ii).

<sup>216</sup> 53 Pa. C.S. 8571 et seq.

<sup>217</sup> 72 P.S. 4751-21, 16 P.S. 6171-B.

<sup>218</sup> 72 P.S. 4751. This is a subsidy.

<sup>219</sup> Pa. Const. Art. VIII, Sec. 2(b)(vi).

<sup>220</sup> 53 Pa. C.S. 8581 et seq.

and qualifications for private forest reserves, agricultural reserves, and land actively devoted to agricultural use, and make special provision for the taxation thereof.”<sup>221</sup> Pennsylvania law has two property tax reduction programs related to such lands. Pennsylvania’s statewide *Farmland and Forest Land Assessment Act* (also known as “Clean and Green” or Act 319) directs county assessors upon application to assess agricultural use land, agricultural reserve land, and forest reserve land at their current use value rather than market value.<sup>222</sup> To be eligible, “agricultural use land” must be at least ten acres or produce a gross income of \$2,000 per year from agricultural commodities, and it must have produced an agricultural commodity for three years prior to application. “Agricultural reserve land” must be at least ten acres and not used for a commercial purpose. Woodlots are eligible if they are less than ten acres and contiguous to, or part of, land that is in agricultural use or agricultural reserve. “Forest reserve land” must be at least ten contiguous acres and must be stocked with trees capable of producing 25 cubic feet of growth per acre annually. Owners of forest reserve and agricultural use lands under the program may exclude the public from the property, owners of agricultural reserve land must allow the public access for outdoor recreation or enjoyment of scenic beauty. In 1998, the law was amended to allow the land under the farmhouse (“the farmstead”) to be valued at the same (preferential) agricultural use value as the farmland. Farm buildings also must be assessed not at replacement value but at their “contributory value” to the fair market value of the whole farm tract.

Clean and Green use value taxation continues indefinitely so long as the use is maintained. Land may also be moved from one use category to another although this may result in a different use value. The Pennsylvania Department of Agriculture annually provides county use values and land use subcategories for use by county assessors. If the Commonwealth’s use value is lower than the assessment currently applied to the landowner, the county must use the lower value; if the Commonwealth’s value is higher, the county may either reassess or continue the existing valuation for enrolled land. Conversion of the land to an ineligible use triggers a roll-back penalty of seven years of back taxes plus interest at 6 percent. The interest is dedicated to county or state agricultural preservation funds. The landowner must notify the assessor at least 30 days before change of the land to an ineligible use, conveyance of the entire parcel, separation of land (division of the parcel by conveyance or otherwise where the resulting parcels meet the qualifications for the program), or split-off of the land (division by conveyance or otherwise where at least one of the resulting parcels does not meet the requirements of the law). Conveyance of the land does not render the land ineligible if the eligible use continues. Separation of the land into parcels does not render the land ineligible if the eligible use continues on each tract, provided that the size or dollar thresholds are met on each tract; but if one of the owners of a separated tract subsequently changes to an ineligible use within 7 years of the separation, that owner is liable for rollback taxes on the entire original tract. A landowner may split-off small tracts without losing eligibility on the remaining main tract, so long as the split-offs do not exceed 2 acres annually (or the minimum lot size of 2-3 acres required by the local

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<sup>221</sup> Pa. Const. Art. VIII, Sec 2(b)(i).

<sup>222</sup> Act 319, 72 P.S. §§ 5490.1-13.



government for a residence), and the land remains in agricultural or forest reserve (or is residential and occupied by the new owner). However, the total amount of split-off tracts may not exceed 10 percent or ten acres of the landowner's original tract. Split-offs in violation of these provisions subject the entire original tract to rollback taxes. A taxing body may forgive rollback taxes if the land is conveyed to a school district, municipality, county, volunteer fire or ambulance company, religious organization for religious use, or to a not-for-profit that covenants to allow public recreation on the land free of charge.<sup>223</sup> Statewide, over 6.1 million acres of land are currently assessed under the Clean and Green law in Pennsylvania's 67 counties.<sup>224</sup>

Pennsylvania's *Act 515* allows counties to enter into covenants with owners to maintain land in open space, farm, forest, or water supply on land designated for such use in a plan adopted by the county planning commission. The landowner agrees to maintain the land for five or ten years in exchange for a property assessment that reflects its value as open space.<sup>225</sup> Lands must be at least 10 acres and have no more than 3 percent area covered by paving or buildings. Farm land must be at least 20 acres and used for raising livestock or growing crops; forest land must be at least 25 acres and used for growing of timber crops. Each year the covenant is extended forward for a year, unless either the county or landowner gives notice that the land's participation will end in ten years. Alteration of the land use in violation of the covenant ends the preferential assessment and requires repayment of five years of rollback taxes plus interest. Only five counties in eastern Pennsylvania participate. Participation has not been high, as use of Clean and Green has tended to dominate the property tax incentive approach. As of 2001, 137,921 acres were assessed under this program.<sup>226</sup>

Under state law, on any land where agricultural easements are acquired by the Commonwealth, county, or nonprofit organization, the land remaining in the hands of the owner must be valued for assessment purposes only for its agricultural use value.<sup>227</sup> This provision is apart from Clean & Green and Act 515. Pennsylvania has acquired easements under its farmland protection programs on over 244,352 acres of farmland.<sup>228</sup>

In addition to these assessment provisions, school districts are authorized, but not

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<sup>223</sup> 7 Pa. Admin. Code 137.1 et seq.

<sup>224</sup> Pennsylvania Dept. of Agriculture, 2001 Clean & Green: Act 319 Summary of Participation. Eight additional counties participate but did not provide acreage figures.

<sup>225</sup> 16 P.S. 11941 et seq.

<sup>226</sup> Pennsylvania Dept. of Agriculture, 2001 Clean & Green: Act 319 Summary of Participation. This figure is less than half of the enrollment for 1993. Center for Rural Pennsylvania, *Zoning for Farming* (1995).

<sup>227</sup> 72 P.S. 5491.3.

<sup>228</sup> Pa. DEP Update, November 22, 2002.

required, to adopt a millage rate freeze for agricultural lands on which an easement has been acquired by the state or county government.<sup>229</sup>

### *Community Revitalization and Redevelopment*

The Pennsylvania Constitution authorizes the General Assembly to establish standards and qualifications by which local taxing authorities may make special provisions for a limited time to encourage “improvement of deteriorating property” by any person, or to encourage industrial development by a nonprofit.<sup>230</sup>

The Local Economic Revitalization Tax Assistance Act (LERTA) authorizes local taxing bodies to offer temporary exemptions from property taxes to improvements to “deteriorated” *industrial, commercial, or business property* located in a “deteriorated area.”<sup>231</sup> The municipal governing authority (a municipality, not a county or school district) must define the deteriorated area before the taxing authority adopts the exemption. The body must consider “blighted areas” and “impoverished areas” as defined in Pennsylvania law, as well as unsafe, unsanitary and overcrowded buildings, vacant, overgrown and unsightly vacant lots, disproportionate numbers of tax delinquent properties, excessive land coverage, defective design or arrangement of buildings, streets or lot layouts, and economically and socially undesirable land uses. Properties adjacent to those with these characteristics may be included in the deteriorated area designation if their improvement would encourage, enhance, or accelerate improvement of the deteriorated properties in the primary area. Local taxing jurisdictions may join together in designations and in defining exemptions. The assessment exemption is capped at the value of the improvement or a maximum amount defined by the taxing body, whichever is less; the exemption may not exceed ten years; and the ordinance must specify the portion of the improvements exempted each year.<sup>232</sup>

In two additional acts, the General Assembly has authorized local government to provide for tax abatement on improvements to deteriorated *residential* property or new residential construction in deteriorated neighborhoods.<sup>233</sup> The Deteriorating Real Property Act provides that the local taxing authority must define the deteriorated neighborhood (using the same criteria as under LERTA), and then adopts the assessment exemption. The exemption is capped at the cost

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<sup>229</sup> 32 P.S. 5007.1.

<sup>230</sup> Pa. Const. Art. VIII, Sec. 2(b)(iii).

<sup>231</sup> 72 P.S. 4722 et seq.

<sup>232</sup> LERTA areas that are also enterprise zones are eligible for tax reimbursement from the state provided that funding is available and that the reimbursement will provide for community development or neighborhood services within the enterprise zone, 72 P.S. 4725.

<sup>233</sup> 72 P.S. 4711-101 et seq. .

of the improvements or a maximum amount specified by the taxing body, whichever is less (but not to exceed \$10,000 per dwelling unit in 1971 as adjusted for construction cost inflation). State law requires the taxing body to adopt either: a ten-year 100% exemption (added in 2002); a ten-year declining exemption (with 100 % exempted in year one, declining by 10% each year), a five-year declining exemption (with 100% exempted in year one, declining by 20% each year), a three-year exemption (with 100% exempt in each of the three years), or some other schedule set by the municipality not to exceed ten years and tied to costs of construction.<sup>234</sup> The Deteriorating Area Improvement Act provides that the municipal governing body must define the area by determining that it is physically blighted. The standards are that residential buildings by virtue of age, obsolescence, inadequate or outmoded design or physical deterioration have become economic and/or social liabilities; or are substandard or unsanitary for healthful and safe living; or are overcrowded, poorly spaced, or so lacking in light and air and space as to be uncondusive to wholesome living; or are faultily arranged, have excessive land coverage, or show a deleterious use of land detrimental to health, safety or welfare; or a significant percentage is more than 20 years old; a substantial amount of unimproved, unsightly vacant land exists and has remained so for 5 or more years indicating lack of utilization; or a disproportionate number of tax exempt or tax delinquent properties are in the area.<sup>235</sup> In these “deteriorating areas,” the taxing body may exempt from all real property taxation the construction of new residences. The assessment exemption is capped at the value attributable to the cost of construction or the maximum amount specified by the taxing body, whichever is less. The same schedules for timing and amount of exemptions apply, except that there is no explicit five-year schedule.

The Pennsylvania Constitution authorizes the General Assembly to provide for special provisions for up to two years to mitigate increased taxes resulting from increased real estate values due to residential construction.<sup>236</sup> Under the New Home Construction Local Tax Abatement Act, Pennsylvania allows local taxing bodies to grant exemptions of up to two years for the construction of residential buildings on unimproved land in any district designated by the body for any reason including, *but not limited to* maintenance of neighborhoods, consistency of zoning districts, rejuvenation of blighted areas, development of vacant land.<sup>237</sup>

Pursuant to another constitutional provision, the General Assembly has established standards and qualifications for taxing authorities in Philadelphia and Allegheny Counties to assist “longtime owner-occupants” whose property values have risen markedly as a result of nearby renovations of deteriorating homes or new construction (gentrification), by providing for

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<sup>234</sup> 72 P.S. 4711-201 et seq., as amended by HB 1945 (2002).

<sup>235</sup> 72 P.S. 4711-301 et seq.

<sup>236</sup> Pa. Const. Art. VIII, Sec. 2(b)(iv).

<sup>237</sup> 72 P.S. 4754-2 et seq.

exemptions from or deferrals of the tax increases.<sup>238</sup>

Pennsylvania in 1998 enacted the Keystone Opportunity Zone Program, to provide exemptions from virtually all taxes (including all local real property taxes, as well as earned income, and state sales and use taxes, state income taxes, and numerous other taxes), in certain areas where reinvestment, jobs, and economic revitalization are needed. These benefits accrue to investors and businesses locating and operating in the KOZs.<sup>239</sup> The legislation provided for designation of twelve Keystone Opportunity Zones of up to 5,000 acres, with up to 20 subzones, where both state and local tax relief would be provided. The program was expanded and extended in 2000, with provision for designation of 12 new Keystone Opportunity Expansion Zones (up to 1,500 acres each - expanded to 3,000 acres in 2002) with up to 8 subzones; and expanded and extended again in late 2002 with provision for designation of new Keystone Opportunity Improvement Zones, as well as “enhancements” that can add property to existing KOZs and KOEZs. The tax relief extends for twelve years; extended to fifteen years for property designated under the 2002 legislation. A property may be placed in a zone only where all of the taxing entities agree to forego taxes, including real property, local earned income, and other taxes. All local governments applying for designation of land as within a zone, subzone, or enhancement must provide 100 percent abatement of all real property taxes; however, they may require investment of up to 25% of the foregone amount in improvement of the property, and nonresident owners of residential property leasing such property for residential use must invest at least 50% of the foregone amount in improvements.<sup>240</sup> Projects in the zones are entitled to priority consideration for loans and assistance programs, and may also be eligible for job creation tax credits against corporate net income taxes, insurance premiums taxes, and other taxes. In its first four years, 391 projects occurred in KOZ/KOEZ zones, producing or retaining over 21,000 jobs. Of these, 35 percent of the projects were on brownfields sites. Total acreage in identified zones is 37,426 acres.<sup>241</sup>

Pennsylvania law authorizes municipalities and counties to engage in tax increment financing of improvements in designated districts in conjunction with redevelopment authorities. The municipality or county must find that the district is a blighted area and that the project is necessary to eliminate such conditions of blight; a school district must decide whether or not to participate in the tax relief. A district may exist for a period not exceeding twenty years.<sup>242</sup>

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<sup>238</sup> Pa. Const. Art. VIII, Sec. 2(b)(v). 72 P.S. 4754-1; 72 P.S. 4749.1.

<sup>239</sup> 53 P.S. 820.101 et seq., as amended including SB 1478 (2002).

<sup>240</sup> 72 P.S. 820.702.

<sup>241</sup> Dept. of Community and Economic Development, KOZ/KOEZ Four-Year Report (January 2003).

<sup>242</sup> 53 P.S. 6930.1-6930.7 (enacted 1990).

## **PERSONAL PROPERTY TAX**

Pennsylvania local governments do not tax personal property. Although Pennsylvania law authorizes a 4 mill county personal property tax applicable to intangible personal property, the tax has been abolished by all Pennsylvania counties, in response to long-running litigation relating to its application to business property and exemptions.<sup>243</sup>

## **LOCAL TRANSFER TAXES AND RECORDING FEES**

In addition to the state real property transfer tax of one percent, state law also authorizes municipalities and school districts to levy a one percent tax on transfers of real property. The one percent tax must be shared equally if both the municipality and school district levy the tax.<sup>244</sup> Home rule municipalities (of which there are a few) may levy at higher rate, as may Philadelphia. Local transfer taxes support general operations.

### **Reductions, Exemptions, Deductions, Credits**

Transfers exempt from the local transfer tax include those by inheritance or mortgage foreclosure; transfers to nonprofit housing and industrial development corporations; transfers to nonprofit historic, recreation, scenic, agricultural, or open space conservancies; transfers to federal, state, or local governments; trades of residences for newly built residences; and certain transfers among family farm corporations and family members.

## **LOCAL INCOME TAXES**

Municipalities and school districts may tax earned income, but may exempt persons with income of less than \$10,000/year (raised from \$5,000 in 2002). The tax is on total earned income. In general most jurisdictions are limited to a 1 percent rate, which must be shared equally between the municipality and school district where both levy the tax.<sup>245</sup> Municipalities may tax nonresidents, but must credit them for any amount paid to their jurisdiction of residence, to prevent double taxation.<sup>246</sup> School districts may not tax nonresidents. Earned income taxes are

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<sup>243</sup> 72 P.S. 4821. See *Annenberg v. Commonwealth*, 757 A. 2d 333 (Pa. 1998), *Annenberg v. Commonwealth*, 757 A. 2d 338 (Pa. 2000).

<sup>244</sup> 53 P.S.6902(1); 72 P.S. 8101-D et seq..

<sup>245</sup> 53 P.S. 6908. The Philadelphia city earned income tax rate is not capped, but the law restricts nonresident taxation to a lower rate than residents, above a certain cap. The Pittsburgh school district maximum rate is 2% rather than 1%, and is in addition to the Pittsburgh city rate of 1%. The Scranton school district may tax at 1% without revenue sharing.

<sup>246</sup> 53 P.S. 6914. However, municipalities must credit their residents for nonresident wage taxes paid to Philadelphia. *Id.* All Pennsylvania school districts and virtually all municipalities

subject to the overall limits on local government taxes imposed by the local tax enabling act; however the limits do not apply to home rule municipalities, distressed municipalities, open space taxes approved by the voters, and school district taxes approved by the voters under Act 50. (Under Act 50, enacted in 1998, school districts could with voter approval adopt an earned income tax of up to 1.5% with offsetting elimination of per capita, occupation, occupational privilege taxes, and reduction of the real estate tax rate - beginning by adopting homestead exclusion). Legislation enacted in 1996 allows municipalities to enact an open space earned income tax on residents by referendum. The rate is set by the referendum.<sup>247</sup>

## **OTHER LOCAL BUSINESS OR OCCUPATION TAXES**

Pennsylvania law authorizes most local governments to levy a per capita or “head tax.” Second-fourth class school districts, third class cities, and 4th-8th class counties may levy a per capita tax of \$5, and political subdivisions under the Local Tax Enabling Act may levy an additional \$10.<sup>248</sup> Municipalities and school districts and counties may exempt persons with incomes less than \$10,000.

Occupations may be taxed by third class cities, boroughs, first class townships, and 4th-8th class counties. Counties that levy a per capita tax cannot also levy the occupation tax. The occupation tax is levied only on residents, and must be assessed at a uniform amount for each occupation defined in the ordinance.<sup>249</sup> Under the various municipal codes, the tax rate applied to the assessed “value” of the occupation must be the same as the rate for the real property tax. (Assessed values must bear some rational relationship to one another, but are not based on gross receipts or income; they are assigned on a local schedule of value that is essentially arbitrary.) The occupation tax is also authorized by the Local Tax Enabling Act, which authorizes municipalities to apply either a \$10 flat tax or a millage rate against the assessed value of the occupation.<sup>250</sup> Thus, municipalities may base their occupation tax on either source of authority. The millage authority under the Enabling Act is not capped, and some of these rates may be fairly high. School districts levying in more than one county must use the lower of the assessed valuations for the occupation. Local governments may exempt persons with incomes under \$10,000/year from the tax.

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levied the earned income tax, with the exceptions being primarily among municipalities in the metropolitan Philadelphia area, where the City taxes nonresident earned income and does not have to credit the municipality of domicile.

<sup>247</sup> 32 P.S. 5007.1.

<sup>248</sup> 24 P.S. 6-679; 53 P.S. 37531; 16 P.S. 1770; 53 P.S. 6908.1

<sup>249</sup> 16 P.S. 1770; 53 P.S. 37531; 53 P.S. 46302; 53 P.S. 56709. Philadelphia and its school district may levy the tax, 53 P.S. 15971, 16101, but do not do so.

<sup>250</sup> 53 P.S. 6908(7).

A separate, but similarly named, “occupational privilege” tax may be levied on the privilege of conducting an occupation within the taxing district. It is authorized by the Local Tax Enabling Act for municipalities and school districts at the maximum rate of \$10 per year. (School districts and municipalities must share the tax).<sup>251</sup> Municipalities and school districts may exempt persons with incomes under \$10,000/year.<sup>252</sup>

Local business gross receipts taxes, if adopted prior to December 1, 1988, may be levied on the privilege of doing business.<sup>253</sup> Business gross receipts taxes cannot be levied on manufacturers nor on public utility services.<sup>254</sup> Gross receipts taxes cannot be levied where the state has preempted the field - as in taxes on banks. The gross receipts tax is limited to one mill on wholesale vendors and one and one-half mills on retail dealers and restaurants (2 mills on retail and restaurants in Pittsburgh).<sup>255</sup> Taxes on wholesale and retail and restaurants, if levied by the municipality and the school district, must be shared. Gross receipts taxes (business privilege taxes) on other types of businesses, including services, are not limited in rate, and no sharing is required. Philadelphia levies a business privilege tax based on gross receipts.<sup>256</sup> Philadelphia also levies a tax on gross receipts of parking lots at 15%.<sup>257</sup> A number of localities have also taxed parking gross receipts under the Local Tax Enabling Act.

Business licenses taxes may be levied by second class, second class A and third class cities on a flat rate basis – limited to \$100 for third class cities.<sup>258</sup> These license taxes are in addition to business privilege taxes.

Other business taxes are authorized, particularly for Philadelphia (not in the Bay watershed). It levies a use privilege tax on commercial and industrial property including vacant

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<sup>251</sup> 53 P.S. 6908(8).

<sup>252</sup> 53 P.S. 6902.

<sup>253</sup> 72 P.S. 4750.533. But this limitation does not bar new flat rate business privilege taxes.

<sup>254</sup> 53 P.S. 6902.

<sup>255</sup> 53 P.S. 6908(2). In addition, the Public School Code authorizes the Pittsburgh School District to levy a mercantile tax, including amusement and recreation businesses, of ½ mill on wholesale and 1 mill on retail. 24 P.S. 582.4, and the district may also levy gross receipts taxes. 24 P.S. 652.1(4)

<sup>256</sup> 53 P.S. 16181.

<sup>257</sup> 53 P.S. 15971.

<sup>258</sup> 53 P.S. 23107; 53 P.S. 37601; 1901 P.L. 20, Art. XIX, sec. 3 Third Class City Code 2601.

property, at a rate of 46.2 mills on commercial and industrial use (based on assessed value of real estate) and a rate of 100 mills on vacant lots.<sup>259</sup>

## **LOCAL SALES AND USE TAXES**

Philadelphia and Allegheny counties (not in the Bay watershed) are authorized to impose a local sales and use tax of one percent.<sup>260</sup>

## **TRAVEL/ENTERTAINMENT TAXES**

Certain counties are authorized by law to levy a tax on hotel rooms; but municipalities may not levy such a tax.<sup>261</sup>

Municipalities and school districts may levy taxes on amusements and admissions at a rate not to exceed 10 percent of the amount charged.<sup>262</sup> The tax must be shared if levied by both the municipality and the school district. School district may not adopt such a tax after June 1997, and municipalities enacting the tax after that date are limited to 5 percent.<sup>263</sup> The tax may be assessed against only 40 percent of the cost of a ski lift ticket or greens fee.<sup>264</sup>

## **IMPACT FEES**

Pennsylvania local governments are authorized to adopt ordinances requiring developers to pay impact fees in connection with offsite transportation capital improvements attributable to the need created by new development.<sup>265</sup> The fee may be assessed only where a transportation capital improvements plan has been adopted prior to the enactment of the ordinance. Impact fees may not be assessed for non-transportation purposes. Municipalities that adopt joint municipal comprehensive plans may also adopt joint transportation impact fee ordinances.<sup>266</sup> Municipal

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<sup>259</sup> Governor's Center for Local Government Services, Taxation Manual (1999), p. 63.

<sup>260</sup> 53 P.S. 12720.503; 16 P.S. 6152-B (Allegheny County's tax goes half to the "regional asset district", and one-fourth each to the county and municipalities).

<sup>261</sup> Allegheny, Bucks, Delaware, Montgomery, Philadelphia, Berks, Luzerne, Blair, Cambria, Centre, York, Lackawanna.

<sup>262</sup> 53 P.S. 6908(6). Philadelphia may not exceed 5 percent. 53 P.S. 15971.

<sup>263</sup> 53 Pa. C.S. 8402(c).

<sup>264</sup> 53 Pa. 6908(9),(10).

<sup>265</sup> 53 Pa. Stat. Ann. 10501-A et seq., MPC 501-A et seq.

<sup>266</sup> 53 Pa. Stat. Ann. 10508-A.



taxes on residential construction are prohibited.<sup>267</sup>

## **OTHER TAXES**

Under special state legislation, Philadelphia levies a ten percent tax on liquor for the benefit of Philadelphia schools.<sup>268</sup>

Local landfill privilege taxes are prohibited after 1987, limiting municipalities to the \$1 per ton provided by state law.<sup>269</sup>

### **PENNSYLVANIA TAX SUMMARY**

Considering all state and local taxes together, property taxes in Pennsylvania account for 27.4 percent of all tax revenues, the personal income tax 25.1 percent, the corporate income tax 4.4 percent, sales and fuels and excise taxes 29.6 percent, license fees 6.6 percent, and other taxes 6.9 percent of tax revenues.

Pennsylvania's local governments and school districts are heavily dependent upon the real property tax. The real property tax provides more than 50 percent of municipal government revenues, more than 90 percent of county revenues, and more than 85 percent of school district local revenues. School funding is especially dependent on local property taxes. The state share of public education funding has declined drastically from about 54 percent in 1970 to 36 percent currently, and individual school districts have also suffered from a distribution formula that was frozen in 1991, not taking into account changes in fiscal capacity or enrollment.

Sources: Pa. Governor's Center for Local Government Services, Taxation Manual (1999), p. 3; 10,000 Friends of Pennsylvania, School Finance and Sprawl (2002). Maryland Department of Legislative Services, "Revenue and Expenditure Comparisons for Maryland and Selected States," Presentation to the Commission on Maryland's Fiscal Structure (Aug. 8, 2002).

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<sup>267</sup> 53 P.S. 6902.

<sup>268</sup> 53 P.S. 16133. The City of Pittsburgh is seeking similar authority.

<sup>269</sup> 53 P.S. 4000.1301.

## CHAPTER FOUR - VIRGINIA TAXES

The Virginia Department of Taxation administers most state taxes levied by the Commonwealth. These include the individual and corporate income taxes (and bank franchise tax), and the state sales and use tax, as well as estate taxes, the real property transfer tax, and several other taxes. The income tax and sales and use taxes account for more than 93 percent of state tax revenues collected by the Department of Taxation.<sup>270</sup> Under Virginia's Constitution, state taxes and other state revenues may not exceed the amount required for the necessary expenses of government, including indebtedness, but the Commonwealth may maintain a "revenue stabilization fund" not to exceed ten percent of the average annual revenues derived from income and retail sales taxes.<sup>271</sup>

The primary local governments in Virginia with taxing authority are the 95 counties and 40 independent cities (which are not part of any county). Virginia also has towns, which are local governments with limited taxing powers that are located within counties. School districts do not have their own taxing authority but are funded from local and state government revenues. Virginia cities and counties tax real and personal property, sales and use, business licenses or merchant capital, transfers of real property, probate of wills, and certain other taxes. A few cities may levy an income tax.

### STATE TAXES

#### STATE INCOME TAXES

The Virginia individual income tax is calculated based largely on federal taxable income, with some adjustments. The tax is levied at a top rate of 5.75 percent on income over \$17,000/year (with lower rates for the amounts below this).<sup>272</sup> In addition to Virginia personal exemptions for all taxpayers and their dependents, Virginia also provides an additional credit of \$300 for low-income taxpayers and each of their dependents.<sup>273</sup>

The corporate income tax rate is 6 percent.<sup>274</sup> It is based on federal taxable income, with certain adjustments.<sup>275</sup> Taxable corporate income is apportioned to Virginia by using a formula

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<sup>270</sup> Virginia Department of Taxation, Annual Report - Fiscal Year 2001.

<sup>271</sup> Va. Const. Art. X, Section 8.

<sup>272</sup> Va. Code 58.1-320.

<sup>273</sup> Va. Code 58.1-339.8.

<sup>274</sup> Va. Code 58.1-400.

<sup>275</sup> Virginia Department of Taxation, Virginia Tax Facts (2001).

that weights sales at 50 percent and payroll and property at 25 percent each. The corporate income tax is not imposed on public service corporations taxed on their gross receipts, insurance companies taxed on gross premiums, or bank and trust companies taxed on net capital. It is also not imposed on nonprofit religious, educational, benevolent and other corporations exempt from federal income taxation.<sup>276</sup>

## **Reductions, Exemptions, Deductions, Credits**

### *Conservation and Land Management*

Virginia does not tax the gain derived from the sale or exchange of real property or an easement which “results in the real property or the easement thereto being devoted to open-space use...for a period of time not less than thirty years.”<sup>277</sup>

Virginia’s Land Conservation Incentives Act provides an income tax credit of fifty percent of the fair market value of “any land or interest in land located in Virginia which is conveyed for the purpose of agricultural and forestal use, open space, natural resource, and/or biodiversity conservation, or land, agricultural, watershed and/or historic preservation, as an unconditional donation in perpetuity by the landowner/taxpayer to a public or private conservation agency eligible to hold such land and interests therein for conservation or preservation purposes.” Dedications of open space for the purpose of fulfilling density requirements to obtain subdivision or building permits are not qualified donations under the law. The conservation, agricultural or historical use must be assured in perpetuity. The credit is limited to \$100,000, and unused portions of the credit may be carried over for five years.<sup>278</sup> If the credit is taken, the taxpayer may not also claim a credit under Virginia law for costs related to the same project. If the credit is taken, the taxpayer also cannot claim the subtraction allowed for the gain on the sale of land or easements conveyed for “open-space use” (see above) for three years following the year in which the credit is taken.<sup>279</sup> In 2002, the General Assembly amended the law to authorize taxpayers to transfer unused credits or portions of credit to another taxpayer for use on another Virginia income tax return, thus enabling persons with little or no Virginia income tax liability to enjoy the full benefit of the credit.<sup>280</sup>

Virginia offers a tax credit to “any individual who owns land abutting a waterway on

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<sup>276</sup> Va. Code 58.1-401.

<sup>277</sup> Va. Code 58.1-322.C.22, 58.1-402.C.16 (Virginia subtraction from federal adjusted gross income).

<sup>278</sup> Va. Code 58.1-512.

<sup>279</sup> Va. Code 58.1-513.

<sup>280</sup> Va. Code 58.1-513, as amended.

which timber is harvested, and who forbears harvesting timber on certain portions of the land near the waterway” in accordance with guidelines developed by the State Forester, including that the buffer be 35-300 feet in width and of a minimum duration of 15 years. The credit is 25 percent of the value of the timber in the area retained as buffer, not to exceed a total credit of \$17,500 or the total tax due in the year of harvest, whichever is less. Unused credits may be carried over for five years. If the buffer is harvested in violation of the commitment in the taxpayer’s stewardship plan after the credit is taken, the credit must be repaid.<sup>281</sup> Thirteen taxpayers took advantage of this credit in 2000.<sup>282</sup>

Virginia allows a tax credit of 25 percent of the expenditure of the first \$70,000 expended by an individual or corporation engaged in agricultural production for market for “agricultural best management practices” if the taxpayer has in place a soil conservation plan approved by the local Soil and Water Conservation District. The practice must be one approved by the Virginia Soil and Water Conservation Board “which will provide a significant improvement to water quality in the state’s streams and rivers and the Chesapeake Bay and is consistent with other state and federal programs that address agricultural, nonpoint-source-pollution management.” Eligible practices include, but are not limited to “livestock-waste and poultry-waste management; soil erosion control; nutrient and sediment filtration and detention; nutrient management; and pest management and pesticide handling.” The total credit is limited to \$17,500 or the total amount of tax in the year the project was completed, whichever is less. Unused portions of the credit may be carried over for five years.<sup>283</sup>

Virginia allows a tax credit of 25 percent of expenditures made for the purchase of equipment certified by the local Soil and Water Conservation District as providing “more precise pesticide and fertilizer application” by an agricultural producer with an approved nutrient management plan. Many kinds of sprayers, applicators, and other equipment are eligible. The credit is limited to \$3,750 or the total amount of tax in the year of purchase, whichever is less. Unused portions of the credit may be carried over for five years.<sup>284</sup>

Virginia allows a tax credit of 25 percent of expenditures made “for the purchase and installation of conservation tillage equipment used in agricultural production.” The credit is limited to \$2,500 or the total amount of tax in the year of purchase, whichever is less. Unused portions of the credit may be carried over for five years.<sup>285</sup>

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<sup>281</sup> Va. Code 58.1-339.10, 58.1-439.12.

<sup>282</sup> Cathy Early, Va. Dept. of Taxation, communication Dec. 10, 2002.

<sup>283</sup> Va. Code 58.1-339.3, 58.1-439.5.

<sup>284</sup> Va. Code 58.1-337, 58.1-436.

<sup>285</sup> Va. Code 58.1-334, 58.1-432.

Virginia does not tax the amount of any qualified contribution of agricultural products to a tax exempt 501(c)(3) organization for human consumption and use.<sup>286</sup>

### *Community Revitalization and Reinvestment*

Virginia allows a low-income housing tax credit for the first five taxable years in which a federal low-income housing tax credit is awarded.<sup>287</sup>

Virginia provides, through December 31, 2005, a rental reduction tax credit for landlords who provide reduced rents to low income tenants who are over 62, disabled, or who have been homeless prior to the commencement of the lease; provided that the rent is at least 15 percent below the rent charged market-rate tenants. The credit is limited to 50 percent of the rent reductions, and may be carried over for five years; annual statewide credits may not exceed \$50,000.<sup>288</sup>

Virginia allows a historic rehabilitation tax credit of 25 percent of eligible expenses incurred in rehabilitating a certified historic structure (listed on the Virginia Landmarks Register, certified as eligible for listing, or certified as contributing to the historic significance of a historic district that is listed on the register).<sup>289</sup>

Virginia has 56 enterprise zones, which are economically distressed areas designated by the governor. Three state tax credits are available. Businesses and individuals in the zones are eligible for an income tax credit (or credit against insurance license tax, or public service corporation tax, or intangible personal property tax) of 80 percent of the tax attributable to the conduct of business within the zone the first year, and 60 percent in years 2-10, when they create up to 50 jobs in an enterprise zone with a capital investment of up to \$15 million. The credit is larger and determined by agreement when the size of the investments and number of jobs created are greater.<sup>290</sup> Virginia also offers a refundable credit for improvements to real property in enterprise zones for substantial investments. The credit is 30 percent of the cost of qualified improvements for investments with the maximum credit over a five year period capped at \$125,000. Alternatively, a larger investment may qualify for a negotiated credit of up to 5 percent of the total investment where the project invests more than \$100 million and creates 200 jobs.<sup>291</sup> State tax credits for enterprise zones are capped annually statewide and approved pro

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<sup>286</sup> Va. Code 58.1-322(C)(14), 58.1-402(C)(13).

<sup>287</sup> Va. Code 58.1-336, 58.1-435.

<sup>288</sup> Va. Code 58.1-339.9.

<sup>289</sup> Va. Code 58.1-339.2.

<sup>290</sup> Va. Code 59.1-280.

<sup>291</sup> Va. Code 59.1-280.1.

rata. Local governments may offer local tax credits and incentives to complement state incentives; most of these are business license tax abatements or real property tax partial exemptions.<sup>292</sup> The enterprise zone program expires July 1, 2005 unless extended by the General Assembly.<sup>293</sup>

Virginia offers a tax credit for up to 45 percent of the amount donated by a business firm or individual in accordance with the Neighborhood Assistance Act.<sup>294</sup>

*Job Creation/Industrial Benefit (General)*

Virginia recognizes a major business facility job tax credit for each new job created over a threshold number of jobs (\$1,000 per job over a threshold). The threshold is 100 jobs (50 in enterprise zones and distressed areas). The credit, which is not offered after Jan. 1, 2005, is taken in equal installments over three years with a ten-year carryover.<sup>295</sup>

Virginia offers business tax credits for investments in technology industries or research and development in tobacco-dependent localities.<sup>296</sup>

Virginia has a tax credit for qualified equity and subordinated debt investments in small businesses (but not those engaged in financial services, insurance, real estate or construction), provided the stake is held for at least five full calendar years. The 50 percent credit is not to exceed the lesser of the tax imposed or \$50,000 but may be carried over for fifteen years; the statewide amount of credit available annually is limited to \$5 million.<sup>297</sup>

Virginia recognizes a day care investment tax credit of up to 25 percent of capital costs for employer-provided daycare facilities (capped at \$25,000). The credit may be carried over for three years.<sup>298</sup>

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<sup>292</sup> Va. Code 59.1-283. Virginia Economic Development Partnership, *A Virginia Guide to Local Taxes on Business* (2002). The prior state exemption from state sales taxes for businesses in enterprise zones expired.

<sup>293</sup> Va. Code 59.1-284.01

<sup>294</sup> Va. Code 58.1-333, 58.1-430; 63.1-320 et seq. A taxpayer's use of the credit is limited to \$175,000 in any taxable year.

<sup>295</sup> Va. Code 58.1-439.

<sup>296</sup> Va. Code 58.1-439.13, 58.1-439.14.

<sup>297</sup> Va. Code 58.1-339.4.

<sup>298</sup> Va. Code 58.1-439.4.

Virginia has a worker retraining tax credit of 30 percent of retraining costs, subject to a statewide cap of \$2.5 million.<sup>299</sup> Virginia offers a tax credit of five percent of salary (not to exceed \$750) for hiring former welfare recipients.<sup>300</sup>

### *Energy/Recycling Incentives*

Virginia offers a recycling equipment tax credit of 10 percent of the capital costs of certified machinery and equipment for processing recyclable material. Use of the credit is limited to 40 percent of taxable income in any one year, but may be carried over for ten years. It expires Jan. 1, 2004. The credit is also available against individual income taxes. (A somewhat different 10 percent recycling credit is authorized through Jan 1, 2003 for corporations making major capital investments in Virginia).<sup>301</sup>

Virginia offers a tax credit of fifty percent of the purchase of equipment that is used by a business exclusively for burning waste motor oil received from the public. The total credit is not to exceed \$5,000.<sup>302</sup>

Virginia provides a tax credit of ten percent of the federal deduction allowed for clean fuel vehicles and clean fuel refueling equipment under the federal internal revenue code. The credit may be carried over for five years.<sup>303</sup> Virginia also provides for a tax credit of \$700 for each job created in clean fuel vehicle manufacturing or retrofitting or conversion until January 1, 2007; the credit may be carried over for up to five years.<sup>304</sup>

Virginia allows a tax credit of \$3 per ton to electric power generators purchasing and consuming Virginia-mined coal. The credit may be carried over for five years.<sup>305</sup> Virginia also provides for a tax credit of \$1-2 per ton for producers of Virginia coal by underground methods and 40 cents per ton for surface methods, and one cent per million BTU of Virginia coalbed methane, in order to encourage the coal industry in the Commonwealth. The producer credit and the generator credit cannot both be claimed on the same ton of coal. The producer credit, if not fully used by the producer, may be redeemed by the Commonwealth in cash at 85 percent of the value of the credit (with the remaining 15 percent going to the coalfield redevelopment fund). In

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<sup>299</sup> Va. Code 58.1-439.6.

<sup>300</sup> Va. Code 58.1-439.9.

<sup>301</sup> Va. Code 58.1-439.7, 58.1-439.8.

<sup>302</sup> Va. Code 58.1-439.10.

<sup>303</sup> Va. Code 58.1-438.1.

<sup>304</sup> Va. Code 58.1-439.1.

<sup>305</sup> Va. Code 58.1-433.1.

general, the credit may not be claimed until three years after the coal was mined. The credit expires at the end of 2007, and the last credit used in 2010.<sup>306</sup>

## **OTHER BUSINESS TAXES**

Virginia taxes the net capital of banks and trust companies at one percent, but allows any county, city, or town to impose a local tax not to exceed 80 percent of the state tax with a credit allowed against the state tax.<sup>307</sup> The state corporation commission imposes license taxes on insurance companies based on gross premiums,<sup>308</sup> taxes on public service corporations, as well as taxes on rolling stock of motor vehicle carriers.<sup>309</sup> Special regulatory revenue taxes based on gross receipts are also levied on telecommunications companies, water companies, railroads, motor carriers, and the Virginia Pilots Association.<sup>310</sup>

## **ESTATE TAX**

Virginia imposes an estate tax equal to the amount of the federal credit allowed for state death taxes. It is a “pick-up” tax applicable only to estates subject to federal taxation. Virginia has not decoupled its tax from the federal estate tax, which is scheduled to allow rising exemptions and then abolition for one year before returning at previous levels.<sup>311</sup>

Virginia levies a probate tax on wills and estate administrations of 10 cents per \$100 of value for estates exceeding \$10,000. Proceeds go to the general fund.<sup>312</sup> (Cities and counties may levy an additional tax equal to 1/3 of the state tax.)<sup>313</sup>

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<sup>306</sup> Va. Code 58.1-439.2.

<sup>307</sup> Va. Code 58.1-1200 - 1217.

<sup>308</sup> Va. Code 58.1-2501.

<sup>309</sup> Va. Code 58.1-2608, 58.1-2626, 58.1-2652.

<sup>310</sup> Va. Code 58.1-2500, 58.1-2600. A tax on electricity and natural gas consumption is imposed in place of the former gross receipts tax, regulatory revenue tax, and local license tax formerly levied on electric power and natural gas utilities. Va. Code 58.1-2900 et seq.; 58.1-2904-2907.

<sup>311</sup> Va. Code 58.1-900 et seq. The federal estate tax is briefly discussed in Appendix A to this report.

<sup>312</sup> Va. Code 58.1-1712.

<sup>313</sup> Va. Code 58.1-1718, 58-1-3805.



## STATE SALES AND USE TAXES

Virginia levies a 3.5 percent retail sales tax on gross receipts, which applies to sales of tangible personal property, furnishing of transient accommodations, and lease or rental of tangible personal property, and a use tax to capture sales made out of state.<sup>314</sup> (There is a corresponding 1 percent local sales/use tax, discussed below, resulting in a 4.5 percent rate throughout the Commonwealth.) Of the 3.5 percent state sales tax: 0.5 percent goes to the Transportation Trust Fund; 1 percent goes to local governments for education based on local school-age population; and 2 percent goes to the general fund. However, portions of the general fund share of sales and use taxes have been designated by the General Assembly to support ports, airports, and mass transit; and revenue generated by the sales and use tax on hunting and fishing equipment is designated to support the game protection fund.<sup>315</sup>

Virginia's 3 percent tax on the purchase of motor vehicles is administered by the Department of Motor Vehicles. The tax is one and one-half percent on clean special fuel vehicles.<sup>316</sup> The proceeds of the tax are dedicated to the "construction, reconstruction and maintenance of highways and the regulation of traffic thereon and for no other purpose."<sup>317</sup>

Sale of a manufactured home is taxed at 3 percent, and a mobile office at 2 percent.<sup>318</sup> The proceeds of these taxes are returned to the city, town, or county where the structure is located.

Aircraft sales and use tax is 2 percent of the purchase price, with proceeds dedicated to aviation.<sup>319</sup> The watercraft sales and use tax is 2 percent of the purchase price, capped at \$2000; the proceeds go to the general fund.<sup>320</sup>

### **Reductions, Exemptions, Deductions, Credits**

Nonprescription and prescription drugs are exempt from sales and use taxes. The sales tax on food is slated for gradual phase down by 2% over four years through 2004, but the phase-

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<sup>314</sup> Va. Code 58.1-603, -604.

<sup>315</sup> Va. Code 58.1-638.

<sup>316</sup> Va. Code 58.1-2402.

<sup>317</sup> Va. Code 58.1-2425(A).

<sup>318</sup> Va. Code 58.1-2402.

<sup>319</sup> Va. Code 58.1-1500 et seq.

<sup>320</sup> Va. Code 58.1-1400 et seq.

down is held in abeyance where state revenues are not adequate to support it.<sup>321</sup>

Manufacturers are exempt from tax on purchases used directly in production; distributors do not pay the tax on items purchased for resale; tangible personal property purchased for use in basic research and development is exempt; gas, electricity, and water are exempt. Exemptions also include purchases for agricultural production or for processing; pollution control equipment; machinery and other goods used in harvesting forest products for sale; machinery and other goods used in commercial fishing; machinery and goods used in mining and processing; fuels used in manufacturing, production, research. Exemptions also apply to numerous specific educational, media, medical, nonprofit, and other organizations.<sup>322</sup> Tax exempt organizations constructing low-cost homes for low-income persons are eligible for a refund of sales and use taxes paid for materials.<sup>323</sup>

## VEHICLE FUEL TAXES

The Virginia Fuels Tax Act is administered by the Department of Motor Vehicles. It taxes fuels at the point of transfer from the terminal to a licensed distributor. Gasoline is taxed at 17.5 cents per gallon, diesel at 16 cents per gallon, aviation gas at 5 cents per gallon, aviation jet fuel at 5 cents per gallon (on the first 100,000 gallons) and 0.5 cents per gallon (above the first 100,000 gallons).<sup>324</sup> Certain administrative discounts are allowed. There is a storage tank fee on certain fuels, including gasoline and diesel, of 3/5 cent per gallon.<sup>325</sup>

Revenues from the fuels taxes are deposited into special funds within the Commonwealth Transportation Fund.<sup>326</sup> No portion of the funds collected on highway fuels “shall be used for any purpose other than the construction, reconstruction or maintenance of the roads and projects comprising the State Highway System, the Interstate System and the secondary system of state highways and expenditures directly and necessarily required for such purposes, including the retirement of revenue bonds.”<sup>327</sup> Aviation fuel taxes are used for aviation purposes. The tax on fuels consumed in tractors and farm vehicles is rebated, except for one-half cent per gallon which is used for the Virginia Agricultural Foundation Fund. The tax on fuels consumed by commercial

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<sup>321</sup> Va. Code 58.1-611.1.

<sup>322</sup> Va. Code 58.1-609.1 through 609.10.

<sup>323</sup> Va. Code 58.1-608.1

<sup>324</sup> Va. Code 58.1-2217.

<sup>325</sup> See generally Virginia Department of Motor Vehicles, Virginia Fuels Tax Guidelines (August 2000).

<sup>326</sup> Va. Code 58.1-2289.

<sup>327</sup> Id.

watercraft is rebated, except for one and on-half cents per gallon, which is used to acquire and improve boating access areas and for other activities of direct benefit to boating (or where the fuels were consumed by commercial fishing boats, for the construction, repair, and maintenance of public docks). For non-commercial watercraft, after refunds, the General Assembly designates the remainder for improvements of public docks, fisheries, environmental improvements, and the like.<sup>328</sup>

The Virginia Motor Fuels Tax is a special 2 percent additional tax that is assessed on motor fuel sales in cities and counties where there is a transportation district with a rapid heavy rail and bus commuter transportation system (Northern Virginia Metro; and the Potomac and Rappahannock Transportation Commission). The proceeds are deposited to a special fund account for distribution to the applicable transportation district.<sup>329</sup> The tax generated \$30 million in FY 2001.

Motor carriers operating in Virginia pay a road tax equivalent to 19.5 cents per gallon, credited to the Highway Maintenance and Operating Fund within the Commonwealth Transportation Fund.<sup>330</sup>

## **TRAVEL/ENTERTAINMENT TAXES**

Rental vehicles are taxed by the Commonwealth at a rate of 4 percent of gross proceeds, and an additional tax of 4 percent on daily rentals.<sup>331</sup> These taxes are collected by the Commonwealth and the daily rental tax distributed quarterly to the city, town, or county where the vehicle was rented, while the other portion of the tax is dedicated to the Commonwealth Transportation Fund and used to meet expenses of the Department of Motor Vehicles.<sup>332</sup>

## **REAL AND PERSONAL PROPERTY TAXES**

Real property is taxable only by local governments and not by the Commonwealth.<sup>333</sup> Tangible personal property, except for the rolling stock of public service corporations, may be taxed only by local governments.<sup>334</sup> The Commonwealth taxes rolling stock of railroads and

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<sup>328</sup> Id.

<sup>329</sup> Va. Code 58.1-1720.

<sup>330</sup> Va. Code 58.1-2701.

<sup>331</sup> Va. Code 58.1-2402.

<sup>332</sup> Va. Code 58.1-2425.

<sup>333</sup> Va. Const. Art. X, Section 4.

<sup>334</sup> Va. Const. Art. X, Section 4.

freight car companies at \$1 per \$100 of assessed value and distributes the proceeds to the counties, cities, and towns where the property is located.

## **STATE TRANSFER TAXES AND RECORDING FEES**

Virginia levies a state recordation tax on deeds of conveyance and other recorded instruments. The tax is 15 cents per \$100 of value conveyed. Deeds of trust are taxed at 15 cents per \$100 of value, with a declining rate above the first \$10 million of value.<sup>335</sup> (Cities and counties may levy a local recordation tax of up to 5 cents per \$100.<sup>336</sup>) Revenue from the state recordation tax goes to the state general fund. However, a portion of the revenue from the state recordation tax is dedicated to transportation development in the U.S. Route 58 corridor (\$40 million), and to transportation in Northern Virginia (the amounts collected from northern Virginia counties and cities).

In addition there is a “grantor tax” of 50 cents per \$500 of value (exclusive of lien amount). The revenue from the grantor tax is divided with local governments.<sup>337</sup>

### **Reductions, Exemptions, Deductions, Credits**

The state recordation tax does not apply to colleges and nonprofit educational institutions; to religious institutions using the real estate for religious purposes; to federal, state or local governments; to nonprofit hospitals; to the United Daughters of the Confederacy; to transfers by will or inter vivos trust; to certain intracorporate and partnership transfers; or to low-income housing nonprofits located in a specific county or city. The recordation and grantor taxes, and local recordation taxes do not apply to any conveyance by gift or lease to The Nature Conservancy for open space purposes.<sup>338</sup>

## **OTHER TAXES**

Taxes on electricity and natural gas consumption are levied by the State Corporation Commission in place of the former gross receipts tax, regulatory revenue tax, and local license tax formerly levied on electric power and natural gas utilities. The tax is levied on the consumers of electricity and natural gas, and include a state tax, a regulatory tax to support the Commission, and a local tax.<sup>339</sup>

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<sup>335</sup> Va. Code 58.1-800 - 816.1.

<sup>336</sup> Va. Code 58.1-3800.

<sup>337</sup> Va. Code 58.1-800 - 816.1.

<sup>338</sup> Va. Code 58.1-811.

<sup>339</sup> Va. Code 58.1-2900 et seq.; 58.1-2904-2907.

Virginia assesses a writ tax for commencing actions in court. The tax is \$5 (or \$25 where the amount in controversy exceeds \$100,000). Proceeds go to the general fund.<sup>340</sup>

Virginia's cigarette tax is 1.25 mills per cigarette (2.5 cents per pack), with the proceeds going to the general fund.<sup>341</sup>

Alcoholic beverage taxes are administered by the Department of Alcohol Control. Profits of ABC stores are divided between the state general fund and localities, as is the wine liter tax (\$0.40/liter), resulting in about \$28 million to local governments in FY2002. Excise taxes on alcohol (20 percent on distilled spirits/4 percent on wine sold in ABC stores) and the malt beverage tax (\$7.95/barrel) go to the general fund. General fund proceeds in FY2002 were \$160 million.<sup>342</sup>

Special state taxes are levied on particular products and production, with the proceeds earmarked either to product promotion and research, or to addressing the effects of the product on Virginia's environment:

The corn assessment of 1 cent per bushel is dedicated to a fund for marketing and research for corn products.<sup>343</sup>

The cotton assessment of 85 cents per bale is dedicated to a fund for promotion and research on cotton.<sup>344</sup>

The egg excise tax is 5 cents per 30 dozen shell eggs or 11 cents per hundredweight liquid eggs, and supports a fund for promotion and research relating to egg products.<sup>345</sup>

The peanut excise tax of 15 cents per hundred pounds supports a fund for promotion, education, and research on peanuts.<sup>346</sup>

The sheep assessment of 50 cents/head sold supports a fund for market development and

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<sup>340</sup> Va. Code 58.1-1727.

<sup>341</sup> Va. Code 58.1-100 - 1022.

<sup>342</sup> <http://www.abc.state.va.us>.

<sup>343</sup> Va. Code 3.1-1031 - 1049.

<sup>344</sup> Virginia Dept. of Taxation, Virginia Tax Facts 2001, p. 41.

<sup>345</sup> Va. Code 3.1-796.11:1 - :10.

<sup>346</sup> Va. Code 3.1-647 - 665.

research related to the sheep industry.<sup>347</sup> Legislation authorizes a slaughter hog tax of 10 cents per head (and 5 cents for feeder pigs) to support a fund for the Virginia pork industry.<sup>348</sup>

The small grains assessment of ½ percent of net price per bushel supports a fund for market development and research.<sup>349</sup>

The soybean assessment of ½ percent of net market value per bushel supports a fund for market development and research on soybeans.<sup>350</sup>

The forest products tax is assessed at various rates on logging activities and forest products, based on the type of product, size of operation, and amount of wood logged or processed (e.g. \$1 per 1000 board feet of lumber). The proceeds are dedicated to a fund administered by the Department of Forestry for conservation of forest resources and to support reforestation activities. Half the tax collected in any city or county must be allocated for expenditure within that city or county.<sup>351</sup>

The Virginia litter tax of \$10 is levied on business establishments that may generate litter (an additional \$15 for manufacture/distribution of groceries, soft drinks, beer). Proceeds are dedicated to the Litter Control and Recycling Fund.<sup>352</sup> The Virginia soft drink excise tax is levied on wholesalers and distributors, based on gross receipts. The rate is \$50 for gross receipt less than \$100,000, ranging up to \$6,000 for >\$10 million. The proceeds are dedicated to the Litter Control and Recycling Fund.<sup>353</sup>

The tire tax is levied at 50 cents per tire sold at retail, with proceeds to the Waste Tire Trust Fund.<sup>354</sup>

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<sup>347</sup> Virginia Dept. of Taxation, Virginia Tax Facts 2001, p. 50.

<sup>348</sup> Va. Code 3.1-763.6 - .13.

<sup>349</sup> Virginia Dept. of Taxation, Virginia Tax Facts 2001, p. 51.

<sup>350</sup> Va. Code 3.1-684.1 - 684.19.

<sup>351</sup> Va. Code 58.1-1600 through 58.1-1622.

<sup>352</sup> Va. Code 58.1-1706 et seq.

<sup>353</sup> Va. Code 58.1-1700 et seq.

<sup>354</sup> Va. Code 58.1-640 et seq. The designation to the Waste Tire Trust Fund was repealed in 1993. 58.1-643.

## LOCAL TAXES

Counties, cities, and towns levy taxes to support local government operations, capital expenditures, and schools. Virginia is a Dillon rule state, which means that grants of authority to local governments are strictly construed, and that local governments are deemed to have only those powers expressly granted by the General Assembly or necessarily implied by an express grant. In general cities have more taxing powers than do counties, although specific legislation has granted similar powers to a number of counties.<sup>355</sup> Typically, the General Assembly enacts legislation affecting specific counties and cities by defining them in terms of their population as of a specific date (in order to avoid specific legislation naming particular jurisdictions). The Virginia Constitution places limits on the bonded indebtedness of cities, towns, and counties, with various exceptions.<sup>356</sup>

The Virginia Constitution authorizes the General Assembly to provide by law for the sharing of government functions, including the financing thereof, among any of the units of local government; or to allow such sharing with a regional government.<sup>357</sup>

Virginia's cities, counties, and towns are authorized to develop revenue, tax base or economic growth sharing agreements. The agreements may be limited to specific purposes, such as public services or economic development.<sup>358</sup> Where the county's participation results in creation of a debt to a locality, the county voters must approve the agreement by referendum. Agreements must be submitted to the Commission on Local Government for state review.<sup>359</sup>

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<sup>355</sup> See generally, Division of Legislative Services, Overview of Local Taxing Authority, <http://dls.state.va.us/groups/taxcode/localtax.pdf>. Towns or cities with charters are generally granted the authority to levy any tax not prohibited by the General Assembly, essentially the opposite of the rule applicable to counties and other cities, which require specific legislative authorizations in order to levy each tax.

<sup>356</sup> Va. Const. Art. VII, Section 10.

<sup>357</sup> Va. Const. Art. VII, Section 3.

<sup>358</sup> Va. Code 15.2-1301.

<sup>359</sup> Albemarle County and the City of Charlottesville have had a revenue sharing agreement since 1982, which allocates a portion of new real property tax revenues to a revenue and economic growth sharing fund, distributed annually between the jurisdictions by formula.

## REAL PROPERTY TAX

Real property is taxable only by local governments and not by the Commonwealth.<sup>360</sup> Virginia's Constitution requires that "all property shall be taxed" except as otherwise provided in the constitution. Taxes must be uniform upon the same class of subjects within the territorial limits of the local government levying the tax.<sup>361</sup>

Under the Virginia Constitution, all real property must be assessed at its fair market value. Real property assessment includes the value of the land, minerals, standing timber, buildings and improvements. Although the taxable value is scheduled at 100 percent of fair market value, because of volatility in real property values and the varying timing of periodic assessments by most Virginia jurisdictions, the actual taxable value is typically somewhat below 100 percent. However, a recent review shows that assessed values for nearly all counties and cities are mostly higher than 80 percent of market value, with many above 90 percent.<sup>362</sup>

The tax rate is set each year by the county or city. The funds generated are retained by the city or county of location, and provide funding for local schools as well as governmental operations and debt service. Tax rates in Virginia in 2000 ranged from \$0.33 per \$100 of assessed value to a high of \$1.41 per \$100.<sup>363</sup> Commercial and residential property is taxed at the same rate. A recent law has authorized a pilot split rate taxation program for land and buildings in Fairfax County.

The real property tax accounts for more than 46 percent of city tax revenue and more than 55 percent of county tax revenues.<sup>364</sup>

### **Reductions, Exemptions, Deductions, Credits**

Virginia's constitution exempts from state and local property taxation: property owned by state or local government; real property owned and exclusively occupied for religious worship or housing of ministers; nonprofit burial grounds; property owned by public libraries and other

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<sup>360</sup> Va. Const. Art. X, Section 4.

<sup>361</sup> Va. Const. Art. X, Section 1. The General Assembly may authorize differences in real property tax rates for areas added to a city or town. Id.

<sup>362</sup> Virginia Economic Development Partnership, A Virginia Guide to Local Taxes on Business (2002).

<sup>363</sup> Virginia Economic Development Partnership, A Virginia Guide to Establishing a Business (2002).

<sup>364</sup> Division of Legislative Services, Overview of Local Taxing Authority, <http://dls.state.va.us/groups/taxcode/localtax.pdf>.



nonprofit institutions of learning; intangible personal property exempted by statute; land subject to a permanent easement permitting inundation by water if exempted by statute; and property used by its owner for “religious, charitable, patriotic, historical, benevolent, cultural, or public park and playground purposes” as may be provided by local ordinance.<sup>365</sup> Certain of these properties – some local government lands, nonprofit cemeteries, libraries, charitable lodge buildings, and various designated organizations – may be subject by local ordinance to a “service charge” in lieu of taxes for police, fire, and refuse collection.<sup>366</sup> Commonwealth-owned property may be subject to a service charge if it constitutes more than three percent of the value of all property in the county, city, or town, excluding state hospitals, educational institutions, and public roads and rights of way.<sup>367</sup>

Exempt property not owned by the Commonwealth that generates revenue or profit – by lease or otherwise – is subject to taxation as though it were non-exempt.<sup>368</sup>

The Constitution also authorizes the General Assembly to authorize local governments to exempt in whole or in part “real estate and personal property designed for continuous habitation owned by, and occupied as the sole dwelling of, persons not less than sixty-five years of age or persons permanently and totally disabled” where they are bearing an extraordinary tax burden relative to their resources.<sup>369</sup>

#### *Conservation and Land Management*

Easements or other less than fee interests held under the Open-Space Land Act or the Conservation Easement Act, are exempt from taxation, and the remaining interest must be assessed for local property taxation only upon the remaining value.<sup>370</sup> Thus property subject to a conservation easement is taxed only on its value subject to the restrictions of the easement.

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<sup>365</sup> Va. Const. Art. X, Section 6(a), as amended 2002. Va. Code 58.1-3606, - 3607, -3610-3622, 3650.610 et seq.

<sup>366</sup> Va. Code 58.1-3400. The service charge may also include expenses for public education if the exempt property is faculty and staff housing of an educational institution. *Id.* But the charge may not be applied houses of worship or ministers’ residences nor to property exclusively operated for nonprofit private educational or charitable purposes (other than faculty or staff housing). Va. Code 58.1-3402.

<sup>367</sup> Va. Code 58.1-3403.

<sup>368</sup> Va. Code 58.1-3603.

<sup>369</sup> Va. Const. Art. X, Section 6(b). Va. Code 58.1-3210.A. Local governments may also defer tax increases for aged and disabled persons. Va. Code 58.1-3219.

<sup>370</sup> Va. Code 58.1-3205, 10.1-1011.

Under the Virginia Constitution, the General Assembly may “define and classify real estate devoted to agricultural, horticultural, forest, or open space uses, and may by general law authorize any county, city, town, or regional government to allow deferral of, or relief from, portions of taxes otherwise payable on such real estate” if it determines that such relief is in the public interest for the preservation or conservation of real estate for such uses.<sup>371</sup> The General Assembly has provided that counties and cities may adopt a *use value assessment ordinance* for these categories of land use to be assessed at a use value rather than at fair market value. They may also specify zoning districts in which these use value assessments may not be available.<sup>372</sup> Sixty-eight counties and 18 cities have adopted a use value ordinance.<sup>373</sup>

Eligible uses include agricultural land, horticultural land, forest land, and open space. Agricultural and horticultural parcels must be a minimum of five acres, and must be devoted to production of plants and animals for commercial sale (or be under a federal conservation agreement intended to take such land out of production). Forest land parcels must be a minimum of 20 acres, must be devoted to tree growth, and must meet state stocking and productivity standards defining a forest area. Open space use parcels must be a minimum of 5 acres (two acres in certain designated counties and densely populated areas), and must be park or recreation lands, conservation lands, floodways, wetlands, riparian buffers, historic or scenic lands, or lands assisting in community development under the local land use plan. Open space parcels must also be guarded against immediate conversion to developed uses, either by being within an agricultural or forestal district as described below, by a recorded perpetual conservation easement held by a public body, or by a recorded commitment to the local government not to change the use to a nonqualifying use for a period of not less than four years nor more than ten years.<sup>374</sup> In 1998, Virginia law expanded the definition of “open space use” in order to authorize local jurisdictions to offer property tax relief for riparian forest buffer land placed under a perpetual conservation easement.<sup>375</sup>

Use valuations are usually based on productivity indices prepared by the State Land Evaluation Advisory Council.<sup>376</sup> Use value status is lost if the land use is changed, and back

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<sup>371</sup> Va. Const. Art. X, Section 2.

<sup>372</sup> Va. Code § 58.1-3229 et seq.

<sup>373</sup> Roy Seward, Virginia Dept. of Agriculture and Consumer Services, communication November 21, 2002.

<sup>374</sup> Va. Code § 58.1-3233.

<sup>375</sup> 1998 HB 1419 (Virginia), codified at Va. Code 58.1-3230; Commonwealth of Virginia, Riparian Buffer Implementation Plan (July 1998).

<sup>376</sup> Va. Code § 58.1-3236.

taxes at the full value must be paid for the current year and preceding five years.<sup>377</sup> However, local ordinances for use value may also provide for assessment and taxation on a sliding scale which establishes a lower tax for property that is held for longer periods of time. Under the sliding scale option, the county or city enters into an agreement of up to 20 years with the landowner; the rollback taxes for a change in use relate back to the date of the agreement.<sup>378</sup>

Virginia's Agriculture and Forestal Districts Act also relates to use value. It allows county and city governments to designate lands where there is "production for commercial purposes" of agricultural or forest products.<sup>379</sup> While it is up to the county or city government to recognize the district, land within a recognized district is automatically entitled to a use value assessment regardless of whether an use value tax ordinance has been adopted. A minimum of 200 contiguous acres is required for a district. Additional lands may be included if the nearest boundary of the added parcel is within one mile of the boundary of the core or if the parcel is contiguous to another parcel in the district whose boundary is within one mile of the boundary of the core. A district can be initiated only by petition of the landowners and must be approved by the locality. A district may cross into more than one locality if each approves its formation. Landowners in a district must agree to limit development during the period when the district is in effect. Districts must be reviewed by the local government every 4-10 years, and either continued in effect, modified, or terminated. If an owner withdraws land from a district, or changes to an ineligible use, the current year's tax plus five years of roll-back taxes are due. There are approximately 324 agricultural and forestal districts in 27 counties and one city, encompassing 744,339 acres.<sup>380</sup> A similar Local Agricultural and Forestal Districts Act allows certain Virginia counties (with an urban executive form of government) to designate districts of "local significance" with the same tax benefits.<sup>381</sup> The minimum size for the district must be specified in the general ordinance, but may not be less than twenty acres. Lands enrolled in these locally significant districts may not be developed to a more intensive use than the existing use for 8 years from the date of adoption of the ordinance creating the district. Local districts are reviewed at the end of the 8 year period and may be renewed or modified by the county government. The current year's tax plus five years of rollback taxes must be paid upon withdrawal from a locally significant district, plus a penalty equal to twice the taxes due in the year following the withdrawal.

Local governments may separately classify and may partially exempt from taxation "real

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<sup>377</sup> Va. Code 58.1-3237.B.

<sup>378</sup> Va. Code 58.1-3231, -3237.C.

<sup>379</sup> Va. Code § 15.2-4300 et seq; Va. Code 58.1-3231.

<sup>380</sup> Roy Seward, Va. Dept. of Agricultural and Consumer Services, communication Nov. 21, 2002.

<sup>381</sup> Va. Code § 15.2-4400 et seq.

estate that has been improved through the placement of rock or concrete breakwaters, bulkheads, gabions, revetments, or similar structural improvements installed to control erosion, and is used primarily for the purpose of abating or preventing pollution of the waters of the Commonwealth,” to the extent to which the placement increases the property value or in the amount of 50 percent of the cost of such improvements, for not more than fifteen years (on a schedule specified by the local government).<sup>382</sup>

### *Community Revitalization and Reinvestment*

The Constitution authorizes the General Assembly to authorize local governments to provide for “a partial exemption from local real property taxation...of real estate whose improvements, by virtue of age and use, have undergone substantial renovation, rehabilitation or replacement.”<sup>383</sup> Virginia statutes allow local governments to exempt in part from real estate taxes any structure or improvement not less than 15 years old that has undergone “substantial rehabilitation, renovation or replacement for residential use.” The ordinance may grant an exemption for up to the full amount of the increase in assessed value, or an amount up to fifty percent of the cost of the work, for a period of up to 15 years. The tax exemption may be limited by ordinance to particular zones or districts. Eligible multifamily residential replacement structures can exceed the size of the original by up to 30 percent.<sup>384</sup> Local governments may grant a similar partial exemption from real property taxes for up to 25 years for rehabilitation or replacement work converting a hotel or motel to residential if the structure is not less than 35 years old.<sup>385</sup>

Local governments are authorized to grant a tax credit in an amount that offsets prior real estate tax liens against real property taxes for rehabilitation of a residence where it was acquired for rehabilitation and such liens exceed 50 percent of the assessed value of the property.<sup>386</sup> This provision helps to restore vacant and over-liened properties to productive use. Cities may also grant releases of tax liens to facilitate redevelopment of property sold at tax sales.<sup>387</sup>

Local governments may by ordinance authorize partial exemptions from real property taxes for up to 15 years where taxpayers rehabilitate, renovate or replace commercial or industrial structures no less than 20 years old (or 15 if located in an enterprise zone). The

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<sup>382</sup> Va. Code 58.1-3665 (added in 1998).

<sup>383</sup> Va. Const. Art. X, Section 6(h).

<sup>384</sup> Va. Code § 58.1-3220.

<sup>385</sup> Va. Code § 58.1-3220.1.

<sup>386</sup> Va. Code 58.1-3220.01.

<sup>387</sup> Va. Code 58.1-3967, 58.1-3228 and 58.1-3965.1. Such liens remain the personal obligation of the owner of the property at the times the liens were imposed.

exemption may be limited to particular zones or districts. Commercial or industrial replacement structures may be up to 110 percent of the size of the existing structure (in enterprise zones) and 100 percent elsewhere.<sup>388</sup> Nine counties and 22 cities have adopted programs granting tax breaks to rehabilitated industrial or commercial property.<sup>389</sup> In 2002, Fairfax county revised its program to limit the commercial program to designated districts, finding that by making it available county-wide the county had unnecessarily granted a subsidy to development and reconstruction that would have occurred without the incentive.<sup>390</sup>

Counties, cities, or towns may use tax increment financing to support development in locally designated “development project areas.” The tax increment approach uses the increased tax revenue resulting from the increase in assessed value due to the project to fund infrastructure or to support the bonds or other indebtedness used to fund infrastructure or other project development costs.<sup>391</sup>

Local governments may designate local enterprise zones by ordinance.<sup>392</sup> Within these zones the local government provides by ordinance that all or a specified percentage of real property and machinery and tools taxes resulting from increased investment are paid into a fund for improvement of the zone.<sup>393</sup>

Local governments may also exempt or partially exempt from real property taxes environmental restoration sites (viz. brownfields) for up to five years to promote remediation.<sup>394</sup>

Virginia local governments may by ordinance exempt or partially exempt “certified stormwater management developments and property” defined as “any real estate improvements constructed from permeable material” which the Department of Environmental Quality has certified to be designed and constructed or reconstructed for the purpose of abating or preventing pollution by “minimizing stormwater runoff.” Permeable materials must be used for at least 70

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<sup>388</sup> Va. Code § 58.1-3221.

<sup>389</sup> Virginia Economic Development Partnership, *A Virginia Guide to Local Taxes on Business* (2002).

<sup>390</sup> Lisa Rein, “Fairfax Restricts Businesses’ Break for Renovations,” *Washington Post*, August 6, 2002.

<sup>391</sup> Va. Code 58.1-3245 et seq.

<sup>392</sup> Va. Code 58.1-3245.8. They may make such designation contingent on state designation of such a zone under Va. Code 59.1-274.

<sup>393</sup> Va. Code 58.1-3245.10.

<sup>394</sup> Va. Code 58.1-3664.

percent of the surface areas that would otherwise be covered by impermeable materials.<sup>395</sup>

## **PERSONAL PROPERTY TAX**

Under the Virginia Constitution, tangible personal property may be taxed only by local governments, and must be assessed at fair market value.<sup>396</sup> Intangible personal property is not taxed.<sup>397</sup> The personal property tax is levied by counties, cities, and towns and applies to vehicles, boats, trailers, manufactured homes, farm machinery, livestock, machinery and equipment but not capital stock or personal property defined by the state as intangible, and many other tangible goods.<sup>398</sup> Local governments are authorized to tax tangible personal property by class at different rates. Rates are not limited by statute.

Local governments may establish the following classes, among others: computer equipment used in business; aircraft; heavy construction machinery; research and development business property; motor carriers; energy generating and co-generating equipment; machinery and tools used in semi-conductor manufacturing; machinery and tools used in manufacturing; and automobiles and light trucks.<sup>399</sup> Farming and agricultural personal property may be exempted or taxed at a lower rate.<sup>400</sup>

Virginia is engaged in a phase-down of the tax on personal automobiles valued at less than \$20,000. Because the phase-down is tied in part to revenue targets, it has not been fully implemented. During 2002, 70 percent of the tax was abated. During the phase-down, the Commonwealth reimburses local governments for their foregone revenue.

The personal property tax accounts for 13.5 percent of city revenues and 19.7 percent of county revenues.<sup>401</sup>

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<sup>395</sup> Va. Code 58.1-3660.1

<sup>396</sup> Va. Const. Art. X, Section 4 (except for rolling stock of public service corporations); Art. X, Section 2.

<sup>397</sup> Va. Code 58.1-1101, Va. Code 58.1-2690.

<sup>398</sup> Va. Code 58.1-3503.

<sup>399</sup> Virginia Economic Development Partnership, *A Virginia Guide to Establishing a Business* (2002), p. 14.

<sup>400</sup> Va. Code 58.1-3505.

<sup>401</sup> Division of Legislative Services, *Overview of Local Taxing Authority*, <http://dls.state.va.us/groups/taxcode/localtax.pdf>.

## Reductions, Exemptions, Deductions, Credits

Certain business property, including computer applications software; furniture and fixtures of manufacturers; inventory; and merchandise in a Virginia foreign trade zone, is excluded from the definition of tangible personal property.<sup>402</sup>

Constitutional exemptions for both real and personal property are noted above under the discussion of real property.<sup>403</sup> Under the Constitution, the General Assembly may allow local governments to exempt or partially exempt pollution control equipment and solar energy equipment, or do so directly.<sup>404</sup> The Constitution also authorizes the General Assembly to allow local governments to exempt or partially exempt from taxation generating or co-generating equipment installed for the purpose of switching from oil or natural gas to wood or another alternate energy source for manufacturing.<sup>405</sup> Under these provisions, the General Assembly has authorized local governments to exempt or partially exempt certified pollution control equipment, certified stormwater management developments and property, certified solar energy equipment, facilities or devices, and certified recycling equipment from personal property taxation.<sup>406</sup> Twenty two counties and 14 cities have exempted or partially exempted pollution control equipment. Thirteen counties and six cities have exempted or partially exempted solar energy equipment. Six counties and three cities have exempted or partially exempted certified recycling equipment.<sup>407</sup> Three counties have exempted or partially exempted energy conversion and cogeneration equipment.<sup>408</sup>

Local governments in Virginia are authorized to exempt from taxation various other forms of personal property or tax them at a lower rate. This power is used to exempt farm machinery and livestock, household goods, and personal effects. Numerous other provisions authorize local governments to prescribe different rates or tax breaks for motor vehicles used for public or nonprofit charitable purposes, clean fuel vehicles, forest harvesting and silvicultural

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<sup>402</sup> Virginia Economic Development Partnership, *A Virginia Guide to Establishing a Business* (2002), p. 13.

<sup>403</sup> Va. Const. Art. X, Section 6(a), as amended 2002. Va. Code 58.1-3606, - 3607, -3610-3622, 3650.610 et seq.

<sup>404</sup> Va. Const. Art. X, Section 6(d).

<sup>405</sup> Va. Const. Art. X, Section 6(i).

<sup>406</sup> Va. Code 58.1-3660.1 - 3662.

<sup>407</sup> Virginia Economic Development Partnership, *A Virginia Guide to Local Taxes on Business* (2002).

<sup>408</sup> Virginia Economic Development Partnership, *A Virginia Guide to Local Taxes on Business* (2002).

equipment, watercraft, and many other categories.<sup>409</sup>

The General Assembly may also provide for local governments to impose different rates upon tangible personal property owned by persons over 65 or disabled, where they are bearing an extraordinary burden in relation to their income and financial worth.<sup>410</sup>

## **LOCAL TRANSFER TAXES AND RECORDING FEES**

In addition to the state recordation and grantor taxes on deeds of conveyance and other recorded instruments described above, cities and counties may levy a local recordation tax of up to one-third of the state recordation tax (viz. 5 cents per \$100 of value), subject to the same exemptions.<sup>411</sup>

## **PROBATE TAX**

As noted above, Virginia levies a state probate tax on wills and estate administrations of 10 cents per \$100 of value for estates exceeding \$10,000.<sup>412</sup> Cities and counties may levy an additional tax equal to 1/3 of the state probate tax.<sup>413</sup>

## **LOCAL INCOME TAXES**

Most Virginia local governments are not authorized to levy a local income tax. However, counties and cities in northern Virginia, and certain large Virginia cities may levy by referendum an income tax of up to one percent.<sup>414</sup>

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<sup>409</sup> Va. Const. Art. X, Section 6(e). Va. Code 58.1-3504, -3505, -3506.

<sup>410</sup> Va. Const. Art. X, Section 1.

<sup>411</sup> Va. Code 58.1-3800.

<sup>412</sup> Va. Code 58.1-1712.

<sup>413</sup> Va. Code 58.1-1718, 58-1-3805.

<sup>414</sup> Va. Code 58.1-540 (“Any county having a population of more than 500,000, as determined by the 1980 U. S. Census, any county or city adjacent thereto, and any city contiguous to such an adjacent county or city, or any city with a population of at least 265,000, is hereby authorized to levy a local income tax at any increment of one-quarter percent up to a maximum rate of one percent upon the Virginia taxable income.”)



## LOCAL OCCUPATION AND BUSINESS TAXES

Virginia cities, counties, and towns may impose a business license tax.<sup>415</sup> For a business, professional and occupational license, the jurisdiction may charge a license fee of up to \$100 for issuance (\$50 or \$30 in smaller jurisdictions),<sup>416</sup> plus a license tax which may be based on gross receipts at a rate of 16 cents per \$100 for contracting, 20 cents per \$100 for retail sales, 58 cents per \$100 for professional services, and 36 cents per \$100 for all other services and businesses.<sup>417</sup> The tax may not be imposed on businesses with gross receipts of less than \$100,000 (in jurisdictions with population over 50,000) or \$50,000 (in jurisdictions with populations of 25,000-50,000). Certain other limits apply (wholesale merchants - 5 cents per \$100 of purchases; direct sellers - 20 cents per \$100 of retail sales if total sales exceed \$4,000 per year, etc.).<sup>418</sup> If a county and a town impose a license tax on the same business privilege, only the town tax applies (unless the town ordinance otherwise specifies).<sup>419</sup> In the alternative, a local jurisdiction may levy a merchants' capital tax.

Counties and cities may levy license taxes of one percent of gross receipts on coal and natural gas severance, and an additional tax of one percent on severance for road improvement and water supply project purposes; and an additional one percent may be levied on natural gas severance for local general fund purposes.<sup>420</sup>

Local governments may impose a license tax on water companies and telephone companies of 0.5 percent of gross receipts.<sup>421</sup>

A merchants' capital tax may be imposed, but at no higher rate or assessment ratio than was in place in 1978.<sup>422</sup>

Forty-nine counties impose a merchant's capital tax on businesses, using various valuation ratios and differing rates. Forty-one counties impose a business license tax; while all of Virginia's forty cities impose a business license tax. Most business license taxes are levied on

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<sup>415</sup> Va. Code 58.1-3704.

<sup>416</sup> Va. Code 58.1-3703.

<sup>417</sup> Va. Code 58.1-3706.

<sup>418</sup> Va. Code 58.1-3716, -3719.1.

<sup>419</sup> Va. Code 58.1-3711.

<sup>420</sup> Va. Code 58.1-3712, -3713, -3713.4.

<sup>421</sup> Va. Code 58.1-3731, 58.1-2690.

<sup>422</sup> Va. Code 58.1-3509.

gross receipts, and local governments. may exempt or tax certain classes of businesses and not others. Typical license types are retailers, mail order firms, wholesalers and distributors, financial services, and business services.<sup>423</sup>

### **Reductions, Exemptions, Deductions, Credits**

The Virginia Constitution authorizes the General Assembly to allow local governments to exempt or partially exempt business, occupational or professional licenses, or merchant's capital, from taxation.<sup>424</sup>

Local governments may designate technology zones and offer local incentives, including tax incentives for up to ten years. Incentives may include reduction of permit or user fees, regulatory incentives, and reduction of any type of gross receipts taxes.<sup>425</sup>

Local governments may offer local tax credits and incentives to complement state incentives in enterprise zones; most of these are business license tax abatements or real property tax partial exemptions.<sup>426</sup> The enterprise zone program expires July 1, 2005 unless extended by the General Assembly.<sup>427</sup>

### **LOCAL SALES AND USE TAXES**

Cities and counties may impose a one percent sales and use tax in addition to the 3.5 percent state tax.<sup>428</sup> All Virginia cities and counties do so. The 1 percent local sales tax, and 1 percent local vending machine tax are retained by the local government with jurisdiction at the point of sale.

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<sup>423</sup> Virginia Economic Development Partnership, A Virginia Guide to Local Taxes on Business (2001). Virginia Economic Development Partnership, A Virginia Guide to Establishing a Business (2002).

<sup>424</sup> Va. Const. Art. X, Section 6(j).

<sup>425</sup> Va. Code 58.1-3850.

<sup>426</sup> Va. Code 59.1-283. Virginia Economic Development Partnership, A Virginia Guide to Local Taxes on Business (2002). The prior state exemption from state sales taxes for businesses in enterprise zones expired.

<sup>427</sup> Va. Code 59.1-284.01

<sup>428</sup> Va. Code 58.1-605, -606.

## TRAVEL/ENTERTAINMENT TAXES

Virginia cities and towns may tax hotel rooms and admissions.<sup>429</sup> Several counties may levy a ten percent tax on admissions.<sup>430</sup> Any county may levy a tax on hotel rooms of two to five percent, and certain designated counties may levy at a higher rate for specific purposes.<sup>431</sup>

Counties may levy a tax on restaurant meals and beverages at a rate of up to 4.0 percent (which makes a total rate of 8.5 percent including the state and local sales tax). Most counties can levy the restaurant tax only by referendum, while others may do so by ordinance.<sup>432</sup> Thirty counties levy the meals tax.

All cities levy the meals tax, at a rate of their choosing, generally 2.0-6.5 percent.<sup>433</sup> Towns are also authorized to levy a meals tax.

## IMPACT FEES

In general, local governments in Virginia may not levy impact fees. However, state law does authorize counties of 500,000 or more and adjacent localities to enact impact fees only for “reasonable road improvements attributable in substantial part to the new development.”<sup>434</sup>

## OTHER TAXES

In addition to the state tax on electricity and natural gas consumption levied by the State Corporation Commission, all counties, cities, and towns may levy a consumer tax on the utility bills of individuals and businesses; and on telecommunications service. (If a town and county both levy the tax, the tax is paid only to the town).<sup>435</sup> This tax is levied by almost all counties and cities.

In addition to the state cigarette tax, Virginia cities may tax cigarettes up to 15 cents per pack, and charter cities in greater amounts (e.g. Chesapeake and Virginia Beach tax cigarettes at

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<sup>429</sup> Va. Code 58.1-3840.

<sup>430</sup> Va. Code 58.1-3818.

<sup>431</sup> Va. Code 58.1-3819, -3820, -3822, -3823.

<sup>432</sup> Va. Code 58.1-3833.

<sup>433</sup> Division of Legislative Services, Overview of Local Taxing Authority, <http://dls.state.va.us/groups/taxcode/localtax.pdf>.

<sup>434</sup> Va. Code 15.2-2317 et seq.

<sup>435</sup> Va. Code 58.1-3812 et seq.

50 cents per pack). But counties may not tax cigarettes, except as designated by law (Arlington and Fairfax County may do so, but not to exceed 5 cents per pack).<sup>436</sup>

### **VIRGINIA TAX SUMMARY**

Considering all state and local taxes, a recent study shows that property taxes in Virginia account for 29.4 percent of tax revenues, the personal income tax 31.1 percent of tax revenues, the corporate income tax 2.1 percent of tax revenues, sales and fuels and excise taxes 29 percent of tax revenues, license fees 3 percent of tax revenues, and other taxes 5.3 percent of tax revenues.

The Commonwealth depends heavily upon the income tax and sales and use taxes, which account for more than 93 percent of state tax revenues collected by the Department of Taxation.

The main sources of local tax revenues are the real property tax and state payments in lieu of the personal property tax, the local sales tax, the consumer utility tax, and the business and professional license tax. These account for 84 percent of locally-generated revenue for cities and 91 percent for counties. Local tax revenues account for about 60 percent of local government budgets on average; with about 34 percent coming from the Commonwealth and the remainder from federal funds. There is substantial variation in this proportion, with local tax funds accounting for far more of local government budgets in the larger urban and suburban jurisdictions.

Sources: Virginia Division of Legislative Services, Overview of Local Taxing Authority, <http://dls.state.va.us/groups/taxcode/localtax.pdf>. Maryland Dept. of Legislative Services, "Revenue and Expenditure Comparisons for Maryland and Selected States," (Presentation to the Commission on Maryland's Fiscal Structure, Aug. 8, 2002);

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<sup>436</sup> Va. Code 58.1-3830.

## CHAPTER FIVE - CONCLUSIONS

This review of state tax policies is intended to assist the Chesapeake 2000 signatories in identifying:

- elements of existing tax policy that “discourage sustainable development practices or encourage undesirable growth patterns” and
- potential tax policies that can “promote the conservation of resource lands and encourage investments consistent with sound growth management principles.”

Many of the taxes described in this report – such as state-level sales and use taxes – appear to have essentially neutral effects on land use choices. Many other tax policies have very limited effects. This chapter identifies *five* effects of tax policies on development choices in the Bay watershed, and ways in which policies can be modified to address Chesapeake 2000 goals. Among the key land use goals that can be affected by tax policy are the parties’ commitments to “reduce the rate of harmful sprawl development of forest and agricultural land in the Chesapeake Bay watershed by 30 percent,” to “promote redevelopment and remove barriers to investment in underutilized urban, suburban and rural communities,” and to “strengthen programs for land acquisition and preservation [and]...permanently preserve from development 20 percent of the land area in the watershed.”<sup>437</sup>

This chapter also offers a menu of potential policy actions. Most of these will require enactment of statutory changes by the state legislatures. In a few cases, these are administrative changes that can influence local government adoption or implementation of local tax ordinances already authorized by state law.

### **1. Over-dependence on local real property taxes can lead to competition among local governments and encourage zoning that promotes sprawl development.**

Dependence on real property taxes can pose problems for local governments. Typically, revenues from property taxes are not able to keep pace with rising demand for schools, infrastructure, and services. Local governments and school districts that rely heavily on the local real property tax have strong incentives to encourage forms of development that increase tax receipts while not requiring an equivalent expenditure for local public services. These developments, including shopping centers and office parks, are referred to as “good ratables.” They are sought by local governments in preference to land uses that require services while generating less tax revenue – such as low and moderate income housing, for example. This competition for tax base can place pressure on land use planning and zoning decisions that would otherwise take conservation and smart growth land use goals into account.<sup>438</sup> The result is often

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<sup>437</sup> Chesapeake 2000.

<sup>438</sup> Norman Williams, “Halting the Race for ‘Good Ratables’ and Other Issues in

zoning of large amounts of agricultural and forest land for anticipated commercial development (or readily available re-zoning for such development on demand). Often communities will zone for more commercial development than they can rationally expect if the zoned land were all built out, in order to signal their receptiveness to such development. Zoning to prefer good ratables is sometimes called “fiscal zoning.” The same real property tax dependency also encourages local governments to engage in large-lot residential zoning to reduce the quantity of housing and thus the demand for services per acre. Residential large-lot zoning is, like promoting strip commercial development, a contributor to sprawl in the Chesapeake Bay region.

All three Bay Agreement states have tax structures that encourage the pursuit of ratables by local governments. Pursuit of office and commercial development is also somewhat reinforced by state and local tax laws that give more favorable real property tax treatment to homes than to commercial properties – through limits on annual increases in tax rates or assessments, homestead exemptions, and similar mechanisms. These effects of property tax dependency warrant greater attention by state and local governments to land use planning, zoning, and subdivision controls so that the pursuit of ratables results in no greater sprawl than is warranted by the fiscal need for commercial development. Absent a significant shift in tax revenue sources, adoption of stricter land development controls will be needed to offset the effects of fiscal zoning.

Sprawl effects of tax policy can be ameliorated by adopting tax reforms that reduce local governments’ dependency on local real property taxes (e.g., by increasing revenue sharing from state income taxes and other statewide revenues), by programs that allow for tax sharing of ratables by neighboring jurisdictions (to reduce the distorting effects of competition for commercial locations upon land use plans),<sup>439</sup> by stronger comprehensive planning and zoning that recognizes regional goals and pays for services regionally, and/or by assessing impact fees upon residential development in ways that capture needed funds but do not drive residential development into even more remote areas.

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Planning Legislation Reform,” *The Growing Smart Working Papers*, Vol. 1, American Planning Association PAS Report No. 462/463 (1996), pp. 57-61.

<sup>439</sup> In addition to the tax sharing program in Albemarle County, Virginia discussed in this report, such programs have operated in the Minneapolis-St. Paul Metropolitan area and in Dayton, Ohio. See, Myron Orfield, *Metropolitcs* (1997), and David Rusk, *Inside Game-Outside Game* (Brookings Inst. 1999). In each instance some portion of the property tax attributable to new commercial assessments in the region after a specified base year is divided among the jurisdiction where the commercial development is located and the other jurisdictions in the metropolitan area, according to formula. In most cases, the programs have not measurably reduced the rate of sprawl, but have maintained the economic viability of older urban jurisdictions, thus affecting the negative incentives that help promote sprawl. In addition, the programs have reduced the incentives for “fiscal zoning,” potentially resulting in a more coherent development pattern.

Maryland, Pennsylvania, and Virginia do not have the same experiences. Pennsylvania and Virginia local governments are more strongly driven toward fiscal zoning than are Maryland jurisdictions. But all three states have property tax effects that contribute toward sprawl.

### *Maryland*

Maryland local governments rely on local real property taxes somewhat less heavily than do local governments in Virginia and Pennsylvania, and so these effects are somewhat less than in these states. However, Maryland's local real property tax has several features that reinforce the pursuit of commercial ratables. Properties are assessed on a three-year cycle with requirements for a three-year phase-in of the new assessment amounts.<sup>440</sup> This time lag, when coupled with the annual limits on home assessment increases under the "homestead" tax credit,<sup>441</sup> mean that the property taxes from homes lag significantly behind both actual values and behind commercial properties. Commercial property thus bears somewhat more tax burden than homes, and fast-growing counties with rising home prices consequently have revenues lag behind the demand for government services. As a result, local governments have an incentive to compete with one another for commercial development rather than housing. At the same time, fast-growing counties may seek to slow residential housing growth altogether (or to limit it to large lots – which increases assessed value and reduces service demands) in order to prevent demand for services from outstripping revenues.

- Maryland should consider requiring fiscal impact analysis in connection with updates to comprehensive plans and zoning maps.<sup>442</sup> Such analysis should identify what commercial development is reasonable to anticipate, and be clear about the location of such development.

- Maryland should consider adopting legislation to authorize and promote tax-sharing in order to ameliorate the adverse effects of the pursuit of ratables on land use decisionmaking. Without tax-base sharing, the competition for good ratables can lead to situations where counties are played off against towns, or adjacent counties engage in highway interchange zoning seeking to capture development from one another. Maryland's lack of authority for tax-base sharing means that some solutions that involve locating commercial development in one area while spreading tax revenues to another are not available.

- Maryland should consider enacting state legislation requiring some local tax revenue

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<sup>440</sup> Md. Code Ann. Tax-Property 8-104.

<sup>441</sup> Md. Code Ann. Tax-Property 9-105.

<sup>442</sup> Fiscal impact analysis examines the likely tax revenues and infrastructure and service demands of differing patterns of development. It can help local governments make better decisions about development planning. However, it can also be misused to justify fiscal zoning. Its best use is to increase clarity in allocating land for residential, commercial, mixed use, and open space uses without over-allocating these categories.

sharing whenever the commercial opportunity giving rise to the new taxable value has been substantially created by a *state investment* (e.g. commercial development within a given distance from a new state-funded interchange, or resulting from a state economic incentive).

- Impact fees, authorized in much of Maryland for a variety of purposes, provide important support for linking infrastructure with new residential development. This encourages timely planning for infrastructure and recognition of the demands generated by new development. In addition, to the extent that impact fees carry some of the revenue burden (and do so in advance of the demand for services), they modestly reduce the incentives for local governments to pursue commercial and industrial ratables at all costs.<sup>443</sup> However, where neighboring counties have widely different provisions for impact fees, the impact fee may prove to be yet another means of shifting housing to another county while keeping the doors open for commercial development. Impact fees can also adversely affect housing affordability unless fee policies or other policies are tailored to offset these effects. State policy guidance or new legislation on impact fees inside and outside of priority funding areas could be helpful in tailoring impact fees to proper development on the regional landscape— for example, setting fees that are lower within such areas, higher outside such areas.

### *Pennsylvania*

The pursuit of ratables is acute in Pennsylvania because taxes on real property are the primary funding source for its 2566 autonomous local governments that hold all of the land use regulatory power and the Commonwealth’s 501 school districts. This has led to furious competition for tax base, and hence to “fiscal” zoning by municipalities to attract commercial and industrial development, with no regard for its location on the “regional” or even county landscape. Pennsylvania’s law authorizing individual local taxing jurisdictions to adopt a homestead exemption to lower taxes on owner-occupied residential property<sup>444</sup> can make the pursuit of commercial development more attractive from a taxing perspective. To the extent to which more Pennsylvania municipalities and school districts adopt a homestead exemption (or if it becomes more prevalent statewide in connection with property tax relief), this effect will increase.

- Pennsylvania should consider reducing the dependency of school districts and local governments on real property taxes by substituting for some portion of these taxes other state taxes collected on a statewide basis and remitted to localities and school districts on some basis other than real estate valuation.

- Pennsylvania should consider requiring local governments (and counties) to conduct fiscal impact analysis in connection with updates to comprehensive plans and zoning maps. Such

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<sup>443</sup> Development excise taxes, used by some Maryland jurisdictions, perform similarly to impact fees.

<sup>444</sup> 53 Pa. C. S. 8581 et seq.



analysis should identify what commercial development is reasonable to anticipate, and be clear about the location of such development.

- Pennsylvania should consider expanding its authorization for impact fees for new development. Pennsylvania’s impact fee limitations prevent local governments from collecting fees to cover capital expenditures necessitated by developments other than for “offsite” transportation capital improvements.<sup>445</sup> If impact fees are authorized more broadly, state policy guidance or legislation should provide for lower impact fees within priority development and redevelopment areas, and higher fees outside such areas on resource lands; this could be helpful in tailoring impact fees to proper development on the regional landscape, and help to overcome problems with differential fee structures in adjacent townships/boroughs influencing development toward sprawl. Indeed, Pennsylvania may want to consider adopting or authorizing impact fees on a county or regional level, but with funds going to the municipalities and school districts actually providing the services and infrastructure, in order to overcome fragmentation and competition effects of a patchwork of fee/no-fee jurisdictions.

- Pennsylvania should consider improving the assessment process and moving toward a full value assessment. Because assessments were not frequently updated in much of Pennsylvania, and because of the fractional nature of “assessed value” for tax purposes (under the pre-determined or common level ratio) in many counties, there has been little experience in much of the Commonwealth with regularly updated valuations that approach fair market value. As a result, reassessments have led to backlash in Pennsylvania against real property taxes, as reassessments have generally led to substantially higher assessed values and thus to higher real property taxes absent rate reductions. The variations in assessment from one county to the next also may have some effect on land use and development choices – with some rural counties using assessments and ratios that encourage location of exurban housing there, although the effect cannot be measured with confidence.

- Pennsylvania law permits tax revenue sharing among municipalities but limits it to those that have engage in cooperative comprehensive planning.<sup>446</sup> Municipalities that have entered into joint implementation agreements may provide for sharing of tax revenues and fees within the region of the plan. This new authority for tax-base sharing potentially offers solutions that involve locating development in one area while spreading tax revenues to another. The Commonwealth should consider enacting incentive programs promoting the use of this tax sharing authorization in areas of particular importance to conservation and the land use goals of Chesapeake 2000.

- Pennsylvania should consider enacting state legislation requiring some local tax revenue sharing whenever the commercial opportunity giving rise to the new taxable value has been substantially created by a *state investment* (e.g. commercial development within a given

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<sup>445</sup> 53 Pa. Stat. Ann. 10501-A et seq.

<sup>446</sup> 53 Pa. Stat. Ann. 11105.

distant from a new interchange, or resulting from a state economic incentive). The current system creates a series of real property tax windfalls to individual boroughs and townships without regard to regional economic effects or land use impacts.

### *Virginia*

Local real property taxes account for more than half of Virginia county tax revenues. Virginia counties do not have a local income tax (most are barred from levying it), and are not (for the most part) allowed to assess impact fees. This heavy dependence on the real property tax stimulates the pursuit of commercial ratables. The one percent local sales and use tax also adds to the pursuit of retail in preference to other forms of development. So residential construction in counties on the edges of metropolitan areas drives up real property taxes to meet the increasing the demand for services, while counties are compelled to try to make up the difference by attracting retail and commercial development.

- Virginia should consider requiring fiscal impact analysis in connection with updates to comprehensive plans and zoning maps. Such analysis should identify what commercial development is reasonable to anticipate, and be clear about the location of such development.
- Virginia should consider increasing local real property transfer taxes to improve the revenue available to local governments experiencing growth. Currently the local recordation tax is limited to 5 cents per \$100 of value, and the local share of the grantor tax to another 5 cents per \$100,<sup>447</sup> far lower than comparable local transfer taxes in the other states.
- Tax revenue sharing among local governments is authorized in Virginia but has seldom been used.<sup>448</sup> The Commonwealth should consider making this authority easier to use – possibly by eliminating referenda requirements if the tax to be shared is new increment and is dedicated to smart growth purposes. It should also consider legislation or administrative programs promoting the use of the existing authorization for tax sharing in areas important for conservation and the land use goals of Chesapeake 2000.
- Virginia should consider enacting state legislation requiring some local tax revenue sharing whenever the commercial opportunity giving rise to the new taxable value has been substantially created by a *state investment* (e.g. commercial development within a given distant from a new interchange, or resulting from a state economic incentive).
- Virginia should consider authorizing impact fees for residential development. Most Virginia jurisdictions are not authorized to levy impact fees on new development; and those that are authorized must limit such fees to “reasonable road improvements” attributable in substantial

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<sup>447</sup> Va. Code 58.1-3800, 58.1-800 et seq.

<sup>448</sup> Va. Code 15.2-1301.

part to the new development.<sup>449</sup> While Virginia jurisdictions may seek voluntary “proffers” in connection with rezoning requests, the inability to collect impact fees results in new residential development not adequately covering the costs of necessary infrastructure in many cases. State legislation on impact fees inside and outside of priority development or redevelopment areas (lower within such areas, higher outside such areas) could be helpful in tailoring impact fees to proper development on the regional landscape.

- If Virginia moves to reduce local government dependency on real property taxes through greater reliance on state-collected revenues, among the possible sources of revenue that might be considered at least in part are motor fuels and tobacco taxes, which are lower than in surrounding states.

## **2. Non-targeted state and local business tax incentives may work against land use controls.**

Various state and local tax incentives and tax exemptions are broadly available without regard to their impact on land uses. These provisions can subsidize development in places that are inconsistent with Chesapeake 2000 goals. Other incentives which are nominally targeted toward redevelopment of existing built areas, such as tax increment financing, are sometimes too broadly authorized so that they can sometimes support harmful sprawl development as well as sound land uses. A tax policy aligned with Chesapeake 2000 would prevent state subsidies of business investments that induce land consumption and sprawl development.

### *Maryland*

In general, Maryland’s smart growth “priority funding areas” legislation limits most state expenditures and incentive programs to existing built areas and designated growth areas, consistent with Chesapeake 2000 commitments.<sup>450</sup> However, some Maryland tax incentive provisions do not appear to have these limitations.

- Maryland’s “tax increment financing” provisions are not limited to blighted areas or to smart growth areas.<sup>451</sup> Thus these provisions, if not used wisely by county and municipal governments may promote unsound land uses. TIFs could, by law, be made harder to use (or be more strictly limited in use) outside of priority funding areas. Tax increment financing

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<sup>449</sup> Va. Code 15.2-2317 et seq.

<sup>450</sup> For example, the One Maryland tax credit and job creation state income tax credit linked to a local property tax credit, because they are limited to priority funding areas, avoid pitfalls of other states’ economic development incentive programs by assuring that the tax expenditures are consistent with smart growth planning. Likewise “green building” tax credits must be in priority funding areas, or be used at a brownfields site, or if neither, must not significantly expand the square footage of an existing building.

<sup>451</sup> Md. Code Ann. Art. 41, 14-201 to -214.

“development district” areas should be defined in the statute in ways consistent with the Chesapeake 2000 goals and to ensure that such tax relief authority is not used for greenfields development.

- Maryland’s authorization of local real property tax credits of up to 100 percent for new and expanded manufacturing or assembly businesses is not linked to location.<sup>452</sup> This program could be explicitly linked to priority funding areas.

- Maryland’s research and development income tax credit<sup>453</sup> is not limited to priority funding areas, or existing employment centers. Thus, this tax break may contribute modestly to subsidizing development not in accordance with sound land use. The income tax credit for portions of real property taxes paid by public utilities (telecommunications and electricity)<sup>454</sup> also is not linked to priority funding areas and thus may indirectly support new investments not located in such areas.

- Business tax incentives that encourage new locations and new job creation do not take into account where worker housing is likely to be. Thus, even when these are targeted to priority funding areas or designated older communities, they may result in further sprawl. The state should condition the incentive on the adoption of county comprehensive plans that address the location of such housing.

### *Pennsylvania*

- Both the Job Creation Tax Credit and Research and Development Tax Credit apply throughout the Commonwealth and are not targeted to designated revitalization areas or to areas designated for development consistent with Chesapeake 2000 goals.<sup>455</sup> These programs potentially provide some subsidy to greenfields development without applying conditions relevant to land use. (In contrast, the Neighborhood Assistance Program and Keystone Opportunity Zone Program do target their incentives, although some KOZs are quite broad).

- Business tax incentives that encourage new locations and new job creation do not take into account where worker housing is likely to be. Thus, even when these are targeted to designated communities, they may result in further sprawl. The Commonwealth should condition the incentive on the adoption of comprehensive plans that address the location of such housing.

- Tax increment financing for projects in “blighted” areas can support improvements and

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<sup>452</sup> Md. Code Ann. Tax-Property 9-205.

<sup>453</sup> Md. Code Ann. Tax-General 10-721. This credit expires June 30, 2006.

<sup>454</sup> Md. Code Ann. Tax 10-708, 10-712.

<sup>455</sup> 72 P.S. 8801-B, and Act 7 of 1997 as amended..

redevelopment. However, under existing law, areas may be designated because of “the unsafe, unsanitary, inadequate or over-crowded condition of the dwellings therein, or because of inadequate planning of the area, or excessive land coverage by the buildings thereon, or the lack of proper light and air and open space, or because of the defective design and arrangement of the buildings thereon, or faulty street or lot layout, or economically or socially undesirable land uses.”<sup>456</sup> The lack of a clear standard for blight – and particularly the broad authority to grant this substantial incentive for “inadequate planning” or “economically...undesirable land uses – means that such financing may be used in ways that may not support sound land use decisions. TIFs could be made harder to use or be more strictly limited when they are used outside of core urban areas. Tax increment financing development areas should be defined in the statute in ways consistent with the Chesapeake 2000 goals and to ensure that the authority is not used for greenfields development.

### *Virginia*

- Virginia’s major facility job tax credit is available statewide (with some lower limits for enterprise zones and distressed areas).<sup>457</sup> It is not closely tied to smart growth goals, and is slated to expire. If it is extended, it should be legislatively linked to the revitalization goals of Chesapeake 2000 and to location of business facilities near existing infrastructure and older urban areas.<sup>458</sup>

- Business tax incentives that encourage new locations and new job creation do not take into account where worker housing is likely to be. Thus, even when these are targeted to priority areas or designated older communities, they may result in further sprawl. The Commonwealth should condition the incentive on the adoption of county comprehensive plans that address the location of such housing.

- Tax increment financing also can serve as a basis for revitalization in “development project areas.” However, such areas are not limited to “blighted areas” even though the authorizing legislation identifies blighted areas as a basis of need.<sup>459</sup> TIFs could be made harder to use or be more strictly limited when they are used outside of core urban areas. Virginia’s “development project areas” need to be defined consistently with Chesapeake 2000 goals and to ensure that the authority is not used for greenfields development.

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<sup>456</sup> 53 P.S. 1702 (Urban Redevelopment Law), cross referenced in 53 P.S. 6930.3 (Tax Increment Financing Act).

<sup>457</sup> Va. Code 58.1-439.

<sup>458</sup> Economic development incentives other than tax incentives also are frequently disconnected from land use effects. See Environmental Law Institute, *Virginia’s Economic Incentives: Missed Opportunities for Sustainable Growth* (2001). <http://www.eli.org>.

<sup>459</sup> Va. Code 58.1-3245, 58.1-3245.1, 58.1-3245.2

### **3. Higher taxes in older urban jurisdictions encourage a cycle of decline absent offsetting tax and reinvestment policies.**

Older urban jurisdictions dependent on property taxes and other locally collected taxes are often compelled to raise rates as they must support existing infrastructure and services on a declining population base. This further weakens their competitive position for new construction, jobs, and homes. The resulting higher tax rates further penalize private rehabilitation and discourage reinvestment in these places, thus encouraging further sprawl absent tax policies designed to overcome these disadvantages. A number of useful approaches have been pioneered in each of the Bay Agreement states, and can be extended, expanded, and emulated in order to support the land use goals of Chesapeake 2000.

#### *Maryland*

Maryland tax exemptions and credits generally do a good job of supporting redevelopment, low income housing, rehabilitation of historic structures, and conversion of vacant or underutilized commercial space to housing. Maryland should consider continuing or extending these provisions where possible.

- Maryland's neighborhood stabilization state income tax credit<sup>460</sup> tied to the local property tax credit<sup>461</sup> for older urban areas in Baltimore city, Baltimore County, and Prince George's and Montgomery Counties is helpful in promoting homeownership and retention of housing value in older neighborhoods. Slowing or reversing the loss of working homeowners in urban areas is an essential part of assuring the vitality of these areas.

- The refundable certified rehabilitation income tax credit for historic buildings and districts has stimulated substantial reinvestment in Baltimore City and older urban centers.<sup>462</sup> It has been a significant contributor to public and private financing packages for rehabilitation. This has been Maryland's largest tax credit program. Independent reviews of the program indicate substantial job creation and tax receipts as a result of developments supported in part by the credits.<sup>463</sup> The program is slated to expire in 2004. The cost of the program has become an

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<sup>460</sup> Md. Code Ann. Tax-General 10-707.

<sup>461</sup> Md. Code Ann. Tax-Property 9-317(e), -318(d), -326.

<sup>462</sup> Md. Code Ann. Tax-General 10-704.5, Md. Code Ann. Art. 83B, section 5-801 et seq.

<sup>463</sup> See <http://www.preservemd.org/txcrstudy.pdf> (net revenue gains to state and local government). See also G. Epstein and S. Calvert, "Md. may cap development tax credit," Baltimore Sun (Feb. 20, 2002) (noting approved credits in 2001 amounted to \$74 million, although not all cashed in that year). The legislature in 2003 capped commercial use of the credit at \$23 million in 2003 and \$15 million in 2004.

issue in these harder times, but given its substantial net benefits, using the program in key districts to accomplish re-use of old buildings is a strong public policy using state resources to promote substantial private dollar investments. Maryland should consider renewal of this credit as well as further potential targeting in order to optimize its land use benefits. The use of this credit can continue to promote more sound land use if it can be closely linked to related public reinvestment and infrastructure plans as well as to sources of financing.

- Maryland could enact provisions based on Virginia’s authorization of property tax credits for rehabilitation of residences with liens in excess of 50 percent of value, in order to provide a substantial tool for returning vacant and abandoned property to productive use.<sup>464</sup>

- Maryland should consider adopting authorization for split rate taxation like that authorized in Pennsylvania<sup>465</sup> – taxing buildings and land at differing rates – in urban areas and especially priority development areas. Such a tax policy, if land were taxed at a higher rate than buildings, would stimulate investment and reinvestment in improvements in these areas and forestall reversion to vacant lots. Maryland’s constitution allows the legislature to provide for the separate assessment and taxation of land and improvements.

- Maryland could consider legislation reducing the *state* transfer tax for construction or rehabilitation of affordable housing or desired commercial development in older urban revitalization areas.<sup>466</sup> The tax is high enough to make some difference in costs, so enacting a targeted tax break could provide a modest incentive helping to buy down the cost of redevelopment in targeted areas – while not adversely affecting local revenues.

- Tax sharing mechanisms could help improve the viability of older urban jurisdictions losing tax base to the exurbs. Maryland could also consider authorizing an approach modeled on Pennsylvania’s Allegheny County Regional Asset District, where a local sales tax increment is used in substantial part to support amenities that contribute to the region as a whole (e.g. museums, libraries, etc.) rather than simply being a tax-exempt burden to the particular municipality within which they are located.

### *Pennsylvania*

Throughout Pennsylvania older urban areas heavily dependent on property taxes are compelled to raise rates, thus further weakening their competitive position for new construction/jobs/homes. The higher rates then penalize rehabilitation and reinvestment.<sup>467</sup>

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<sup>464</sup> Va. Code 58.1-3220.01.

<sup>465</sup> 53 P.S. 25894, 37531, 46302.1, 24 P.S. 6-672(e).

<sup>466</sup> Md. Code Ann. Tax-Property 13-202.

<sup>467</sup> Research shows that in general Pennsylvania’s older cities and boroughs have

Several programs can ameliorate these effects.

- The Local Economic Revitalization Tax Assistance Act (LERTA)<sup>468</sup> and the Deteriorating Real Property Act and Deteriorating Areas Improvement Act<sup>469</sup> offer local governments flexibility to offer property tax inducements for rehabilitation and reinvestment in areas, dwellings, and commercial property. Keystone Opportunity Zones offer abatement of all taxes in order to create jobs through new investment in designated areas. It may be desirable to examine ways to reduce the tax losses to local governments that seek to use these tools.

- Pennsylvania could consider adopting legislation modeled on Maryland's certified rehabilitation state income tax credit, which has had proven effects in stimulating reinvestment and in promoting reuse and rehabilitation of existing buildings.<sup>470</sup>

- Pennsylvania may also want to consider authorizing local governments to grant partial property tax exemptions for rehabilitation of older buildings without designating specific districts, in order to encourage more spot renovations in older communities.<sup>471</sup>

- Some Pennsylvania cities rely on business privilege gross receipts taxes. These apply to retail, wholesale and restaurant and certain other businesses, but not to manufacturers, banks, media, or utilities. To the extent to which these taxes drive retail businesses to the suburbs, they make the older urban centers less attractive and vibrant places to live and they reduce the competitiveness of downtown service and retail businesses with their exurban competitors. Pennsylvania should consider elevating this tax to a county, regional, or statewide tax with redistribution of revenues to overcome this effect.

- Pennsylvania's law authorizing urban municipalities to use split rate taxation offers a very substantial incentive to put urban land into productive, high-values uses.<sup>472</sup> By taxing land at a higher rate, the split rate tax provides an incentive to construct and maintain high value improvements on the land rather than to leave it vacant or construct and maintain lower value improvements. The positive track record of the tax in Pittsburgh and Harrisburg clearly

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substantially lower tax capacity than their surrounding suburbs. Janet Milkman, *Revitalizing Our Small Cities and Boroughs*, 10000 Friends of Pennsylvania (2002).

<sup>468</sup> 72 P.S. 4722 et seq.

<sup>469</sup> 72 P.S. 4711-101 et seq., 4711-201 et seq.

<sup>470</sup> Md. Code Ann. Tax-General 10-704.5, Md. Code Ann. Art. 83B, section 5-801 et seq.

<sup>471</sup> E.g. Va. Code 58.1-3220, - 3220.1, -3221.

<sup>472</sup> 53 P.S. 25894, 37531, 46302.1, and 24 P.S. 6-672(e),



influenced the General Assembly to extend this power to the boroughs.<sup>473</sup> The state should consider enacting incentives that would encourage the adoption of this tax approach by older urban jurisdictions.

- Philadelphia's business privilege tax on vacant lots may be a useful tool in other urban settings. It accomplishes some of the same things as a split rate taxation separating land and buildings by discouraging the creation and unproductive retention of vacant lots in downtown business districts.

- Pennsylvania could reduce or waive all or part of the Commonwealth's 1 percent real property transfer tax<sup>474</sup> for the construction or rehabilitation of affordable housing and desired commercial redevelopment in revitalization areas. This would not reduce local revenues needed by urban jurisdictions, but could help buy down the cost of redevelopment in targeted areas.

- Pennsylvania could consider enacting an income and property tax credit program like that in Maryland for neighborhood stabilization, that would apply to homeowners in designated urban areas in order to prevent flight, abandonment and decay.<sup>475</sup>

- Pennsylvania could enact provisions based on Virginia's authorization of property tax credits for rehabilitation of residences with liens in excess of 50 percent of value, in order to provide a substantial tool for returning vacant and abandoned property to productive use.<sup>476</sup>

- Pennsylvania school districts rely very heavily on local real property taxes and local income taxes. The real property tax rates are effectively not limited for school districts because of exemptions for salaries and debt service. Thus, school taxes can contribute substantially to the cycle of rising taxes that discourages reinvestment in older urban areas. The highest property tax rates in the Commonwealth are in school districts with high levels of poverty. Pennsylvania should consider legislation under which state tax revenues pick up a larger share of local school expenses, and particularly to buy down rates in distressed areas and areas with a high percentage

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<sup>473</sup> Pittsburgh's abandonment in 2001 of its longstanding tax policy (taxing land value at six times the rate of buildings) was driven by an independent county decision to contract out for a wholesale reassessment of properties throughout the county which resulted in some extraordinarily high increases in land value assessments; the effect of the reassessment on city taxpayers was exacerbated by the higher rates at which land was taxed. In order to smooth out the impact of the reassessment, the city council changed to a uniform rate for land and improvements, thus foregoing the policy benefits of the split-rate tax, but mollifying homeowners who otherwise would have experienced sticker shock on their property taxes.

<sup>474</sup> 72 P.S. 8101-C.

<sup>475</sup> Md. Code Ann. Tax-General 10-707, Tax-Property 9-317(e), -318(d), -326.

<sup>476</sup> Va. Code 58.1-3220.01.

of low-income residents.

- Tax sharing mechanisms discussed above also can help improve the viability of older urban jurisdictions losing tax base to the exurbs. Pennsylvania could also consider authorizing more broadly an approach modeled on its Allegheny County Regional Asset District, where a local sales tax increment is used in substantial part to support amenities that contribute to the region as a whole (e.g. museums, libraries, etc.) rather than simply being a tax-exempt burden to the particular municipality within which they are located.

### *Virginia*

Virginia laws offer various incentives that can help overcome disincentives to rehabilitation and redevelopment.

- Virginia's state income tax credits for construction of low-income housing and for rent reductions to low income elderly and disabled persons are relatively modest but provide some incentives for these investments.

- Virginia's enterprise zone program uses income tax credits for some job creation and improvements to real property.<sup>477</sup> If it is extended in 2005, the program could be refocused to emphasize land use goals as well as economic revitalization.

- Virginia's 25 percent state income tax credit for historic preservation expenditures may assist in smart growth and revitalization, but is limited to certified historic structures or districts.<sup>478</sup> Such a credit could be linked to other revitalization activities.

- Virginia's authorization to local governments to grant partial exemptions from real property taxes for rehabilitation of commercial and industrial buildings can have a significant potential impact on urban revitalization.<sup>479</sup> These exemptions, particularly where targeted to designated areas (and perhaps made subject to state guidelines or best practices guidelines), can stimulate needed reinvestment in preference to greenfields development.

- Virginia's authorization to local governments to partially exempt from real property taxes the rehabilitation or replacement of older homes offers an opportunity to encourage reinvestment, especially if focused on older neighborhoods and designated areas.<sup>480</sup> The Commonwealth should consider ways to incentivize the use of this tool by older urban areas,

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<sup>477</sup> Va. Code 59.1-280.

<sup>478</sup> Va. Code 58.1-339.2.

<sup>479</sup> Va. Code § 58.1-3221.

<sup>480</sup> Va. Code 58.1-3220.

perhaps through linking some state investments and revitalization grant funding to the use of this tool.

- Virginia’s legislation authorizing tax credits for rehabilitation of residences with liens in excess of 50 percent of value can provide a substantial tool for returning vacant and abandoned property to productive use.<sup>481</sup> This program should be coupled with active re-use and vacant property rehabilitation inventory programs.

- Virginia could consider enacting an income and property tax credit program like that in Maryland for neighborhood stabilization, that would apply to homeowners in designated urban areas in order to prevent flight, abandonment and decay.<sup>482</sup>

- The authority of local governments to exempt or partially exempt brownfields restoration sites from real property taxes for up to five years can, if used, promote Chesapeake 2000 goals.<sup>483</sup>

- Tax sharing mechanisms could help improve the viability of older urban jurisdictions losing tax base to the exurbs. Virginia could also consider legislation authorizing an approach modeled on Pennsylvania’s Allegheny County Regional Asset District, where an additional local sales tax increment is used in substantial part to support amenities that contribute to the region as a whole (e.g. museums, libraries, etc.) rather than simply being a tax-exempt burden to the particular city or county within which they are located..

- Virginia should consider adopting authorization for split rate property taxation like that authorized in Pennsylvania<sup>484</sup> – taxing buildings and land at differing rates – in urban areas. Such a tax policy would stimulate investment and reinvestment in improvements in these areas.

#### **4. Tax policies can promote landowner decisions to forgo farm and forest land conversions, and support dedications to conservation uses.**

Open space lands, including those used for economically sustainable farming and forestry are important to the health of the Bay watershed, while providing substantial benefits to adjoining developed communities. In addition, because they require far less in public services per acre, such lands are “good ratables” from a government finance perspective. However, these lands are also prime candidates for new greenfields development – particularly large scale

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<sup>481</sup> Va. Code 58.1-3220.01.

<sup>482</sup> Md. Code Ann. Tax-General 10-707, Tax-Property 9-317(e), -318(d), -326.

<sup>483</sup> Va. Code 58.1-3664. Chesapeake 2000 pledges to “strengthen brownfield redevelopment. By 2010, rehabilitate and restore 1,050 brownfield sites to productive use.”

<sup>484</sup> 53 P.S. 25894, 37531, 46302.1, 24 P.S. 6-672(e).

development. It is important to structure tax policies so that they do not drive farms and forest operations out of business because of constantly rising assessments. At the same time, tax policies can be adopted to discourage or mitigate the conversion of such lands to developed uses.

The primary tax mechanism for these purposes is “use value taxation.” This allows or requires local governments to assess farm and forest lands for property tax purposes not at their highest market value (viz. for development), but at their value for agriculture or forest use. The purpose is to prevent real property taxes from driving owners to make land conversions that would not otherwise be made. A second mechanism taxes land transfers in ways that either give preference to conveyances that keep land in open space uses and/or that generate land acquisition funds that can be used to mitigate the effect of land conversions. A third set of mechanisms includes tax credits and exemptions of various kinds that subsidize continued farm and forest activities, thus improving their economic attractiveness in comparison with other land use choices. In addition to tax provisions that support retention of land in open space uses by private owners, there are tax provisions that can provide incentives for landowners to convey easements and fee simple interests in conservation lands. Finally, state estate and inheritance taxes may have some effect on the ability of family farmers and individual forest land owners to pass their land on to heirs and have it continue in the same use, or to make a charitable conveyance of land or conservation easement.

### *Maryland*

- Maryland’s programs of use value assessments for real property taxation of farm and forest lands<sup>485</sup> help to support maintenance of the lands in productive open space uses.<sup>486</sup> The primary use value programs for farm and forest lands do not provide for recapture of the foregone property taxes in the event of a conversion.<sup>487</sup> Instead, the state imposes a 5 percent agricultural lands transfer tax on the value of the transfer.<sup>488</sup> And the agricultural lands transfer

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<sup>485</sup> Md. Code Ann. Tax-Property 8-209, 8-210, 8-211.

<sup>486</sup> Statewide statistics are not available on acreage subject to agricultural use assessments. Forest lands included in forest land use assessments (or under forest conservation management agreements which also provide for a reduced assessment) total 286,227 acres, involving 5,550 landowner properties. Laura Foussekis, Md. Dept. of Assessments and Taxation, Accounts and Acres in Forestry Programs. Of the forest land total, the Maryland Department of Natural Resources has approximately 1,250 agreements with forest landowners under the Forest Conservation Management Agreement Program, covering 145,000 acres of forest land. <http://www.dnr.state.md.us/Forests/Programapps/fcmp.html>

<sup>487</sup> Md. Code Ann. Tax-Property 8-209, 8-210. In contrast, the Forest Conservation Management Program, Md. Code Ann. Tax-Property 8-211, does provide for recapture of back taxes (relating to the 15-year term of the agreement)

<sup>488</sup> Md. Code Ann. Tax-Property 13-202.

tax does not apply if the land has been taxed at fair market value for the four years prior to conversion. Moreover, the agricultural lands transfer tax of 5 percent is not high enough to recoup the foregone property tax revenue – in higher property tax counties (with rates greater than \$1 per \$100 of assessed value). Thus, the financial penalty is not significant. Essentially, Maryland’s use value taxation helps avoid cash pressures on agricultural land owners who wish to continue farming and forestry activities, but serves as only a minor impediment to land conversion. The state should consider strengthening the use value assessment programs for agricultural lands by providing for recapture of foregone taxes in the event of conversion, as in many of the other states with such programs.

- Maryland’s use value program for farm land does not require the preparation of or adherence to a conservation plan for the lands receiving the tax benefit.<sup>489</sup> Maryland should consider enacting such a requirement as a way of assuring that the tax benefit also serves the goals of Chesapeake 2000, including land use and water quality objectives.

- Maryland’s state real property transfer taxes (the half percent tax on all transfers and the five percent tax on transfers of agricultural lands) have their proceeds dedicated to conservation land acquisition.<sup>490</sup> Thus, a vigorous land sales market – indicative of increased development activity and loss of open space land – automatically provides some mitigation calibrated to the pace of development. Several features of these tax programs could be strengthened:

- Maryland’s five percent agricultural land transfer tax is intended to discourage the conversion of agricultural land to nonagricultural uses, as well as to provide additional funding for agricultural and forest land conservation.<sup>491</sup> However, land may be converted out of agricultural use without payment of the tax if it has been assessed at fair market value rather than agricultural use value for the 4 years preceding the transfer, or if the land is assessed at and actually used for by the purchaser for agriculture for the 5 years following the transfer. A 100-acre agricultural parcel selling for \$5,000 per acre incurs a transfer tax of just \$25,000. While substantial, this is not a heavy obstacle to conversion, and does not even typically recapture the full benefit of the use value taxation. Moreover, the amount of agricultural land transfer tax collected statewide (about \$3 million per year on 12,000-15,000 acres) is insufficient to purchase a corresponding acreage of agricultural easements. The transfer tax amount could be increased, or coupled with enactment of a recapture provision for agricultural use value tax benefits on land that is converted (see above).

- Most non-farm real estate transactions are subject to the one-half percent state transfer

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<sup>489</sup> Md. Code Ann. Tax-Property 8-209.

<sup>490</sup> Md. Code Ann. Tax-Property 13-202.

<sup>491</sup> Md. Code Ann. Tax-Property 13-302.

tax, although first-time home buyers pay a lower rate.<sup>492</sup> This tax could perhaps be made more supportive of sound growth and related goals by reducing the rate only for homes located within priority funding areas or designated revitalization areas, or by eliminating it only for “affordable housing” meeting sound land use characteristics. Conversely, the standard one-half percent rate (which supports open space acquisition) could be *increased* for all non-farm real estate transfers that are outside priority funding areas – or for all non-farm real estate transfers for new homes outside priority funding areas. This approach could generate more funding to mitigate losses of open space and could further encourage focusing development within priority funding areas (or at least help to make development outside such areas more efficient in its use of land).

- Landowners seeking to avoid Maryland transfer taxes and recording fees have structured some major land transactions as sales of land-owning corporations rather than as sales of land, thus depriving the state and counties of funding for land conservation.<sup>493</sup> This strategy threatens to undermine both the funding for conservation in Maryland derived from all transfer taxes, and to vitiate even the modest incentive effects of the agricultural lands transfer tax. Amendment of the provisions will be needed to assure that land transfers structured to avoid the tax are nevertheless subject to it.

- Maryland’s forest income “tax modification” program,<sup>494</sup> allowing landowners to deduct double their reforestation and timber stand improvement expenses on small parcels, is intended to support ongoing forestry uses. This tax program removes one of the typical obstacles facing small noncommercial forest land owners – the fact that ordinarily their management and reforestation expenses have to be capitalized and are not recoverable until many years later. The program currently affects a fairly small amount of forest land. Total participants have been 436 landowners, with just 30-50 taking advantage of the program each year.<sup>495</sup> Thus, the program promotes investment in forest activities on between 300- 5,000 acres per year statewide – generally closer to the lower end of that range. It is not clear whether the subsidized forest management activities are sufficient to change the incentives for landowners’ development choices. If the program were strategically targeted to areas at potential development risk or otherwise important to maintain in timber lands, it might have a greater impact. Maryland may also want to consider making installation of riparian forest buffers an affirmative goal of this program, which might increase its utility for Chesapeake 2000 purposes. Doing so might require legislative changes to the minimum acreage requirements.

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<sup>492</sup> Md. Code Ann. Tax-Property 13-202.

<sup>493</sup> C. Davenport, “Companies Find Legal Way Around Md.’s Transfer Tax,” Washington Post (Dec. 2002).

<sup>494</sup> Md. Code Ann. Tax-General 10-208(i), Md. Code Ann. Nat. Res. 5-219.

<sup>495</sup> Patrick Meckley, Maryland Forest Service, communication dated Jan. 2, 2003; <http://www.dnr.state.md.us/forests/programapps/tax.html>.

- Maryland could consider enacting legislation to encourage private nonindustrial forest landowners to prepare and maintain forest management plans. Land under management plans is more likely to be maintained in open space use. Two approaches could be considered. One would be to amend the income tax modification program described above, which currently allows double deductions for replanting and stand management activities pursuant to planning. Greater use of the incentive and at lower cost to the state might occur if planning itself were subsidized, or if a current year deduction – but not a double deduction – were offered for preparation of a forest plan. The other approach would be to enact an income tax credit for forest landowners with 25-250 acres of forestland for the preparation of a forest plan that meets the goals of Chesapeake 2000. Because forest management planning generally results in greater economic returns to landowners over the long run, the state could conceivably realize enough through later tax collections to offset the cost of the tax incentive. This might provide a way to get more forestland under management plans than under the current use value property tax programs and federal incentive programs and the existing tax modification program.

- Several current tax programs for agriculture help reduce some of the costs imposed by water quality objectives. Maryland offers a subtraction from adjusted gross income of 100 percent of the cost of the purchase of conservation tillage equipment used in farming.<sup>496</sup> Maryland also offers a subtraction from adjusted gross income of 100 percent of the cost of the purchase of poultry or livestock manure spreading equipment used in carrying out an approved nutrient management plan.<sup>497</sup> Maryland also offers a commercial fertilizer tax credit for three-years, up to \$4,500 per year, for 50 percent of the cost of purchase of fertilizer by farmers converting to a required approved nutrient management plan.<sup>498</sup> These tax breaks are intended to support transition to nutrient management for water quality.

- Maryland’s dedication of real property transfer taxes to agricultural land and easement acquisition and open space acquisition is an exemplary program. Because such funds have recently been diverted in part to the general fund to deal with budget shortfalls, action should be taken to restore the funding dedications as soon as it is feasible to do so.

- The state income tax credit for conveyance of a perpetual conservation easement<sup>499</sup> is helpful in promoting donations and below-market conveyances of easements as part of a mix of incentives. Because it is limited to \$5,000 per year over 16 years (thus effectively capped at \$80,000), it is not a strong incentive (particularly for large landowners) absent other incentives. Moreover, where the landowner does not have significant income tax liability, the value of the incentive is even less since it is capped at the lesser of \$5,000 or the tax due in any year.

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<sup>496</sup> Md. Code Ann. Tax-General 10-208(d).

<sup>497</sup> Md. Code Ann. Tax-General 10-208(m).

<sup>498</sup> Md. Code Ann. Tax-General 10-704.9.

<sup>499</sup> Md. Code Ann. Tax-General 10-723.

Approximately 151 taxpayers for the 2001 tax year claimed the credit for donation of a conservation easement at a revenue cost of \$189,620.<sup>500</sup> This incentive could be made more valuable if it were made transferable, thus allowing landowners with low tax exposure to realize a greater return, or to receive funds earlier than they do under the current system.

- Maryland also provides for statewide and authorized county property tax credits applicable to lands over which conservation easements have been conveyed. Lands currently subject to the 15-year property tax credit for lands subject to conservation easements donated to the Maryland Environmental Trust<sup>501</sup> include 392 properties encompassing 42,833 acres.<sup>502</sup> The enactment of this credit in 1986 helped to stimulate donations of conservation easements.<sup>503</sup> The authorized county tax credit for lands subject to easements held by the Maryland Agricultural Land Preservation Foundation may also have an effect, but varies with county activity; the number of parcels potentially eligible include 2517 parcels comprising 211,590 acres.<sup>504</sup> Similar credits can be granted by counties for other types of open space easements.<sup>505</sup> It is possible that for agricultural lands the property tax credit is not a large incentive for conservation because of the ready availability of agricultural use assessment, which keeps taxes fairly low to begin with. It may be desirable to improve the incentives in exchange for focused management practices.

- Maryland requires county and municipal governments to apply a fifteen-year 100 percent property tax credit against all real property taxes on “conservation property,” defined as unimproved land not used for a commercial purpose that is subject to a perpetual conservation easement donated to the Maryland Environmental Trust.<sup>506</sup>

- Maryland’s inheritance and estate taxes may have a small effect on rural landowner decisions. Because they have been decoupled from the federal estate tax they represent some

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<sup>500</sup> Carol Novella, Tax Revenue Analyst, Comptroller of Maryland, communication Dec. 4, 2002.

<sup>501</sup> Md. Code Ann. Tax-Property 9-107.

<sup>502</sup> Laura Foussekis, Maryland Dept. of Assessments and Taxation (2002 data). This is less than the approximately 72,000 acres of donated easements held by MET. Grant Dehart, Maryland Environmental Trust (2002 data). The difference probably reflects timing of the donations and the timing of the tax breaks, as well as whether the tax break was claimed.

<sup>503</sup> Meredith Lathbury, Potomac Conservancy, Jan. 2003.

<sup>504</sup> Md. Code Ann. Tax-Property 9-206. Laura Foussekis, Dept. of Assessments and Taxation, Jan. 6, 2003. Information on the number of acres actually generating tax credits is not available.

<sup>505</sup> Md. Code Ann. Tax-Property 9-108.

<sup>506</sup> Md. Code Ann. Tax-Property 9-107.



independent burden on landowners; however, financial pressures as a whole will be reduced because of the federal estate tax phase-out (See Appendix A). The Maryland inheritance tax already exempts bequests to immediate family members, so is unlikely to add to pressures for sale.

### *Pennsylvania*

● Pennsylvania's widely used use value taxation program for farm and forest land (Clean & Green) provides some relief that enables owners of such land to maintain it as open space rather than be driven to sell the land because of rising taxes based on potential market value.<sup>507</sup> However, full value land assessments are already low in many Pennsylvania counties because reassessments have not occurred for many years. Thus, the tax advantage offered by Clean and Green in some parts of the Commonwealth is very small. As of 2001, approximately 6.1 million acres of land were assessed under Clean & Green assessments. However, enrollments have dropped to some extent, with a net decrease of over 400,000 acres over the previous year among counties that reported on lands in both years. Based on a sample of 29 counties, assessment reductions in comparison with non-participating land ranged from 7 percent to 88 percent, with the average 56 percent. Where land comes out of Clean & Green and into a developed use, a rollback tax of seven years plus interest is due. The largest amounts of rollback taxes were from the counties surrounding Philadelphia and Lancaster, both high sprawl areas.<sup>508</sup> Thus, Clean & Green is only a modest disincentive to development of open space lands in areas of high demand.<sup>509</sup> The Clean & Green program could be strengthened in several ways: It could be strengthened by linking the enjoyment of the tax advantage to requiring the *preparation of a management plan for continued farm, forest, or open space use*. Specifically Pennsylvania should consider whether to include such a requirement as a way of assuring that the tax benefit also serves the goals of Chesapeake 2000 including land use and water quality objectives. If such a requirement were added, it might be appropriate to phase it in over a period of time in order to allow sufficient technical assistance or aid to be provided and/or to target the requirement in particular areas or watersheds. The Clean & Green program could also be strengthened by increasing the rollback tax due upon conversion.

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<sup>507</sup> 72 P.S. 5490.1 et seq.

<sup>508</sup> Pa. Dept. of Agriculture, 2001 Clean & Green: Act 319 Summary of Participation.

<sup>509</sup> A survey by Professor Jacobson at Penn State suggests that the program has a small effect in discouraging conversion of forest lands. The study notes, however, that the lower Clean & Green property taxes on forest land may still represent a fairly high out-of-pocket expense for owners not engaged in harvesting from which they can derive income with which to pay the taxes. But his study further finds that there is no great enthusiasm among forest land owners for switching to yield tax/severance taxes on forest harvests in lieu of Clean and Green property taxes. Also such substituted taxes would need to be quite high (greater than 10 percent) in order to offset full property tax abatements. Michael Jacobson, *Assessment of Pennsylvania's Forest Property Tax* (2002).

- Pennsylvania’s one percent real property transfer tax primarily provides general revenue for the Commonwealth, but part of the tax also supports debt service on conservation land acquisition under the Key 93 program.<sup>510</sup> The small percentage (.15) designated for conservation is very limited, nor is it tied to particular expenditures or to conservation goals that support Chesapeake 2000. The transfer tax could be restructured to more directly mitigate for land development and activity in property transactions. Pennsylvania could, like Maryland, adopt a higher tax for transfers that involve conversion of land from agriculture/forest uses, and could increase the dedication of land transfer taxes to conservation land acquisition purposes.

- Pennsylvania could consider creating an income tax credit to encourage private landowners to prepare and maintain forest management plans, perhaps aimed at nonindustrial forest landowners with 25-250 acres of forest land, in order to encourage them to manage their land professionally. Because forest management planning generally results in greater economic returns to landowners over the long run, the Commonwealth could conceivably realize enough income to offset the cost of a tax credit. This might provide a way to get more forest land under management plans than the current method of relying entirely on federal programs, technical assistance programs, and unsubsidized hiring of consulting foresters by landowners.

- Pennsylvania’s tax on solid waste disposal provides funding for a variety of conservation-oriented purposes under Growing Greener, and could be further dedicated to acquisition activities in support of Chesapeake 2000 goals.

- Pennsylvania could consider enacting an income tax credit for donation of conservation easements modeled on those available in Virginia and Maryland.<sup>511</sup>

- Pennsylvania’s local real property tax system does not provide any additional tax incentives for planting and maintaining riparian buffers, or for conveying conservation easements. The current state law providing that land on which agricultural conservation easements have been conveyed shall be taxed only at its agricultural use value<sup>512</sup> means that such land is treated for tax purposes like farm land under Clean & Green, providing no incentive for easement status. Pennsylvania could consider legislation providing for an additional real property tax break for land on which easements have been conveyed and/or planted and maintained as riparian buffer to bring the property tax amount below the Clean & Green amount.<sup>513</sup>

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<sup>510</sup> 72 P.S. 8101-C et seq.

<sup>511</sup> Va. Code 58.1-512; Md. Code Ann. Tax-General 10-723.

<sup>512</sup> 72 P.S. 5491.3.

<sup>513</sup> The new legislation would need to set a “standard” or “qualification” consistent with the authorization of special taxation provisions for “private forest reserves, agricultural reserves,

● Pennsylvania’s inheritance and estate taxes may have a modest effect on rural landowner decisions. The inheritance tax, in particular, applies to inheritances even from close family members (except spouses, and parents inheriting from children). This may place some pressure on landowners and heirs to sell property. As the federal estate tax is gradually eliminated over the next seven years (although slated to return in 2011, see Appendix A), the state taxes (decoupled from the federal tax), may loom larger in landowner estate planning decisions – although the overall financial pressures will be reduced because of the federal reduction.

### *Virginia*

● Virginia’s agriculture, horticulture, open space, and forest use property tax assessment programs<sup>514</sup> offer some opportunities to reduce property taxes and facilitate conservation. However, none of the programs requires preparation of a conservation or management plan as a condition for participation, except that riparian forest buffers under conservation easements are eligible for use value taxation. Virginia should consider legislation requiring preparation of conservation plan in order to participate in use value taxation programs, and whether to adopt such a requirement as a way of assuring that the tax benefit also serves the goals of Chesapeake 2000 including land use and water quality objectives. If such a requirement were added, it might be appropriate to phase it in over a period of time in order to allow sufficient technical assistance or aid to be provided and/or to target the requirement in particular areas or watersheds. The Agriculture and Forestal Districts Act does broadly authorize Virginia local governments to create “incentives” to induce landowners to impose further “land use and conservation restrictions” on their lands within such districts.<sup>515</sup> The scope of these incentives has not been explored, but might reasonably include assistance in arranging for management plans.

● Virginia’s income tax credit of up to \$17,500 for preserving riparian forest buffers in connection with timber harvests provides a modest incentive to forego such harvesting.<sup>516</sup>

● Virginia could consider creating an income tax credit to encourage private landowners to prepare and maintain forest management plans, perhaps aimed at nonindustrial forest landowners with 25-250 acres of forest land, in order to encourage them to manage their land professionally. Because forest management planning generally results in greater economic returns to landowners over the long run, the Commonwealth could conceivably realize enough income to offset the cost of a tax credit. This might provide a way to get more forest land under management plans than the current method of relying entirely on federal programs, technical

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and land actively devoted to agricultural use” established by Pa. Const. Art. VIII, Sec. 2(b)(i).

<sup>514</sup> Va. Code § 58.1-3233, -3231; Va. Code § 15.2-4300 et seq.

<sup>515</sup> Va. Code § 15.2-4309.

<sup>516</sup> Va. Code 58.1-229.10, 58.1-439.12.

assistance programs, and unsubsidized hiring of consulting foresters by landowners.

- Virginia has a number of income tax credits that help to buy down the costs of remaining in agriculture while improving environmental performance on the land. The tax credit of up to \$17,500 for “agricultural best management practices” helps support agricultural uses of the land by sharing some of the burden.<sup>517</sup> The similar credit of up to \$3,750 for pesticide and fertilizer equipment upgrades also helps to subsidize agricultural use, as does the credit of up to \$2,500 for conservation tillage equipment.<sup>518</sup>

- The Commonwealth’s forest products tax on logging and forest products helps to use economic activity in that sector to generate funds for reforestation and conservation.<sup>519</sup> The proceeds could be more specifically targeted to support Chesapeake 2000 goals.

- Virginia should consider legislation increasing its very low land transfer taxes and dedicate the increase or a portion thereof to acquisition of conservation lands. Virginia’s modest state and local recordation taxes (0.15 percent and 0.05 percent of value, respectively) and grantor taxes (0.1 percent of value) provide minimal revenue. And the revenue goes primarily to state and local general funds rather than to open space or other conservation purposes. Because the rates are so low, the limited exemptions from these taxes available for conveyances to government entities or The Nature Conservancy are neither a substantial financial benefit, nor broad enough to help promote conveyances of conservation easements and lands generally. If Virginia does increase these transfer taxes, it could also consider providing for a reduction of the amounts for affordable housing and redevelopment in designated revitalization areas.

- The transferable Land Conservation Incentives income tax credit of up to \$100,000 provides a substantial boost to donations of conservation easements for conservation, agricultural and forest use, open space and related purposes.<sup>520</sup> The exemption from taxation of the gain on sale of property or easements resulting in long term open-space use is also a meaningful incentive.<sup>521</sup>

- Virginia could adopt a tax on solid waste disposal, as Pennsylvania has, to provide dedicated funding for conservation-land acquisition and related purposes.

- Virginia’s estate tax has no evident effect on landowner decisions currently as it is

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<sup>517</sup> Va. Code 58.1-339.3, 58.1-439.5.

<sup>518</sup> Va. Code 58.1-337, 58.1-436, 58.1-334, 58.1-432.

<sup>519</sup> Va. Code 58.1-1600 et seq.

<sup>520</sup> Va. Code 58.1-513.

<sup>521</sup> Va. Code 58.1-322C.22, 58.1-402.C.16.

limited to the amount of the federal credit, and so does not represent any additional tax burden beyond that which would be imposed by the federal government absent a Virginia tax. Because Virginia has not decoupled its tax from the federal tax, which is slated for elimination over the next seven years (although slated to return in 2011), the state tax has no independent effect. Virginia's very modest probate tax also has no evident effect on landowner decisions.

## **5. Several miscellaneous tax provisions have the potential to operate against the achievement of Chesapeake 2000 goals.**

### *Maryland*

- Maryland's law authorizing local governments to assess "planned development land" of at least 500 acres at its agricultural use rate for property tax purposes does not appear to be fully consistent with Chesapeake 2000 land use goals.<sup>522</sup> Essentially the law was intended to reduce the carrying costs for developers of large planned unit developments on the theory that such developments were more beneficial than piecemeal developments, and on the condition that the developer pay for public infrastructure. However, other Maryland laws now allow counties and municipalities to require impact fees or dedications. The buy-down of the carrying costs provided by this provision is not clearly linked to a smart growth benefit.

- Maryland's tax exemption for seawalls and bulkheads may not always be consistent with Chesapeake 2000 goals.<sup>523</sup> Because it relies implicitly only on state regulatory restrictions for limitations on such structures, it may subsidize some structures that produce purely private benefits and little or no ecological or land use benefit. The related authorization for a locally-defined property tax credit for such structures has the same potential and should be structured to avoid subsidizing measures potentially adverse to water quality and ecological function.<sup>524</sup> Both of these provisions could be re-evaluated and conditioned to assure that desirable environmental benefits, over and above mere private benefits, must be achieved for the use of these tax incentives.

- The property tax reduction for homes with failing septic systems works against Chesapeake 2000 water quality goals.<sup>525</sup>

- The authorization for a property tax credit for unsold homes is a subsidy to the

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<sup>522</sup> Md. Code Ann. Tax-Property 8-222.

<sup>523</sup> Md. Code Ann. Tax-Property 8-238.

<sup>524</sup> Md. Code Ann. Tax-Property 9-217.

<sup>525</sup> Md. Code Ann. Tax-Property 8-237.

development industry.<sup>526</sup> While assisting developers may be a suitable measure for public policy, it could be strengthened if it were linked to requirements of sound land use, such as location of the structure in a priority development area, or requiring characteristics of land use and/or development form (e.g., affordability, conservation design, replacement of existing structure).

- Maryland's Transportation Trust Fund has broader purposes than simply road building, and includes revenue sources that do not put fuel receipts in the position of driving a roads-only or roads-first agenda. Thus Maryland's transportation funding is on a smarter growth footing than that of many states where fuel revenues are inextricably linked with road construction. However, in the near term, this same flexibility has allowed the transportation account to be used for non-transportation purposes because of budget shortfalls; these diversions may or may not serve sound land use goals. If fuel taxes are increased, a portion of the increase could be designated to support transportation enhancements with an emphasis on open space conservation/mitigation.

- Maryland should consider enacting property tax exemptions for "certified stormwater management developments and property" using permeable material, as in Virginia to meet some Chesapeake 2000 goals.<sup>527</sup>

### *Pennsylvania*

- Proceeds from the vehicle fuels taxes are required by the state Constitution to be used for highways and bridges.<sup>528</sup> This provision seriously limits the Commonwealth's flexibility in finding funding for other modes of transportation and should be reviewed. It may be possible to design a system of functionally equivalent fees or other charges in lieu of "vehicle fuels taxes" that allows more flexibility if a Constitutional amendment is infeasible.

- Pennsylvania could consider adopting a provision like Maryland's for a partial tax credit to employers for employer-provided commuter transit and non-automobile travel which would help reduce air pollution and congestion by putting this form of travel on a more equal footing with such benefits as employer-provided parking.<sup>529</sup>

- Pennsylvania's New Home Construction Local Tax Abatement Act provides a basis for temporary tax relief on new home construction; however it is not limited to areas of sound land use and priority development, but allows local governments to designate a district for such relief

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<sup>526</sup> Md. Code Ann. Tax-Property 9-207.

<sup>527</sup> Va. Code 58.1-3660.1

<sup>528</sup> Pa. Const. Art. VIII, Sec. 11(a).

<sup>529</sup> Md. Code Ann. Tax-General 10-715, Md. Code Ann. Environment 2-901.

for any reason.<sup>530</sup> Limiting the use of this provision to designated growth and infill areas could help promote development of these areas in preference to sprawl areas.

- Pennsylvania may be unable to enact property tax exemptions for “certified stormwater management developments and property” using permeable material to meet some Chesapeake 2000 goals, as in Virginia,<sup>531</sup> because of the absence of an authorization for such an exemption in the state Constitution.<sup>532</sup> This issue should be examined to determine whether such a benefit could be provided in some other way.

### *Virginia*

- Existing property tax exemptions for “certified stormwater management developments and property” using permeable material help provide a basis to meet some Chesapeake 2000 goals.<sup>533</sup> This provision could be further strengthened if it were linked to putting such development in the right places on the landscape in accordance with watershed plans or revitalization goals.

- Authority to grant partial exemptions from real property taxes “real estate that has been improved through the placement of rock or concrete breakwaters, bulkheads, gabions, revetments, or similar structural improvements installed to control erosion, and is used primarily for the purpose of abating or preventing pollution of the waters of the Commonwealth”<sup>534</sup> could (because of the last clause) support Chesapeake 2000 goals if the terms for the exemption were carefully spelled out administratively to avoid unduly rewarding hardening of shorelines.

- Virginia’s law limiting the use of the highway fuels tax to “construction, reconstruction, and maintenance” of state roads<sup>535</sup> reduces the flexibility of the system to support alternative modes of transportation improvements and transit. Virginia should evaluate legislation providing alternative funding models. Virginia’s pay-as-you go system for transportation (which discourages the incurring of debt) also means that it is difficult to find a revenue source for capital-intensive expenditures on transportation modes other than highways. However, the Virginia constitution does allow the voters to approve bond issues for capital

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<sup>530</sup> 72 P.S. 4754-2.

<sup>531</sup> Va. Code 58.1-3660.1

<sup>532</sup> Pa. Const. Art. VIII, Sec. 2. See Art. VIII, Sec. 5 (“All laws exempting property from taxation, other than the property above enumerated, shall be void.”).

<sup>533</sup> Va. Code 58.1-3660.1

<sup>534</sup> Va. Code 58.1-3665 (added in 1998).

<sup>535</sup> Va. Code 58.1-2289.

expenditures.

- Virginia could consider adopting a provision like Maryland's for a partial tax credit for employer-provided commuter transit and non-automobile travel to help reduce air pollution and congestion by putting this form of travel on a more equal footing.<sup>536</sup>

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<sup>536</sup> Md. Code Ann. Tax-General 10-715, Md. Code Ann. Environment 2-901.



## APPENDIX A - FEDERAL TAX ISSUES

Federal tax provisions are largely beyond the scope of this study. However, several federal tax issues are briefly identified here to provide context.

### INCOME TAX

Federal income taxes include substantial provisions for adjustments, deductions, exemptions, and credits. Federal taxable income serves as the basis for the state income taxes imposed by Virginia and Maryland (subject to state adjustments). Pennsylvania does not base its state income tax on the federal system. In addition to their effect on some state taxing schemes, federal income tax provisions also have some fairly direct effects on landowner decisions.

Federal cost-share payments to farmers and forest owners are generally excludable from taxable income. This exclusion can help promote participation in such programs. The maximum amount excludable is limited to the present fair market value of the right to receive annual income from the affected acreage.<sup>537</sup> The non-excludable portion of cost-shares is added to the taxpayer's gross income. In contrast with cost-shares, government rental payments for the conservation of land, such as the Conservation Reserve Program, are not excludable and must be reported as income.<sup>538</sup>

Charitable contributions of conservation easements are deductible from adjusted gross income. If not usable in the year of donation, the deduction can be carried forward for five years.<sup>539</sup>

The federal tax code offers an incentive for reforestation of forest land by providing a tax credit of ten percent of the expenses incurred for reforestation, plus allowing the deduction and 7-year amortization of the first \$10,000 per year of reforestation expenses (thus allowing recover of these expenses prior to a later harvest). The tax credit and expense amortization can also be taken for afforestation activities in contemplation of an income-producing timber operation.<sup>540</sup> The reforestation costs not recovered can be capitalized and later reduce the ultimate tax liability on a harvest of the timber.

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<sup>537</sup> IRC 126.

<sup>538</sup> William C. Siegel, William L. Hoover, Harry L. Haney, Jr., and Karen Liu, *Forest Owners' Guide to the Federal Income Tax* (USDA Forest Service, Agriculture Handbook No. 708, October 1995), pp. 37-38.

<sup>539</sup> IRC 170(h).

<sup>540</sup> William J. Siegel, *Timber and Taxes*, National Woodland (Oct. 1999).

Farmers may deduct their ordinary and necessary business expenses for operating the farm. Certain other expenses must be capitalized. The deductibility of forest management expenses creates a complex set of issues, relating to the level of “material participation” in the business of raising and harvesting timber; and the tax treatment of income from timber sales is also quite complex as under some approaches the resulting income is capital gain and under others it is ordinary income.<sup>541</sup>

The tax treatment of development expenses, depreciation schedules for buildings and equipment, and other federal income tax provisions raise issues that affect choices about land development. Land development financing is influenced by tax outcomes for the participating parties, but in general the tax benefits can be allocated among the parties as they see fit by structuring the participation in ways that meet their financial objectives.

Private activity bonds and tax-free government bonds can be used for construction of infrastructure and other development purposes. States and local governments have a great deal of influence over what categories of activities are the subject of such bonded indebtedness. Essentially, while the tax benefit is federal, the affect on the landscape is determined by the state and local decisionmaker deciding that the project should be supported.

## **ESTATE TAX**

The federal estate tax applies to individuals but not to corporations; so its effects are experienced by individual landowners and individual business owners and their heirs.

Maryland, Pennsylvania, and Virginia have estate tax laws (or inheritance and estate tax laws) that take advantage of a provision in the federal law that grants a credit for taxes paid to a state. They impose taxes linked to the amount of that credit in order to take advantage of the amount taxable under federal law, without increasing the total tax paid. However, changes to the federal estate tax enacted in 2001 have made the state tax levy far more complex, and change the relative burden of the state amount.

The estate tax is in a state of flux as the Congress in 2001 voted to gradually raise the size of the estate excluded from any estate tax from \$1 million to \$3.5 million in 2009, and then to repeal the estate tax entirely in 2010 only to resume at 2001 levels in 2011. The link between many state estate and inheritance taxes and the federal tax has caused a great deal of difficulty for estate planners, as well as for those attempting to manage state revenues, in view of these rapid changes. Maryland and Pennsylvania have “decoupled” their taxes from the federal estate tax changes in order not to lose revenue as the exemption amount rises and the tax briefly ends; they now base their taxes on the estate tax as it was prior to the 2001 federal legislation. Virginia has not decoupled its estate tax and hence will realize declining revenues over time in lockstep with the federal changes.

The federal estate tax has at times affected landowner decisions on whether individuals

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<sup>541</sup> See generally, Environmental Law Institute, *Forests for the Bay* (2000), p. 22.

should sell farm and forest land for development and to pay estate tax liabilities; and decisions about whether to donate or otherwise convey conservation easements in order to reduce potential estate tax liability. In some respects, the increased exclusions (and temporary abolition of the tax) enacted in 2001 should reduce pressures to sell in order to pay taxes. But they may also reduce incentives to donate conservation easements. At the same time, the prospect of the tax springing back into life (at 2001 levels) in 2011 makes it very difficult to plan effectively how to shelter estates from taxation (short of a suicide strategy in 2010). Everyone expects Congress to enact further changes, but the form and timing are unknown.

Under federal estate tax law, there is a “farm use value” reduction allowed where land and personal property are used in a farming operation by members of the decedent’s family. This reduces the value of the property subject to tax or takes it below the threshold for taxation.<sup>542</sup> This existing provision has mitigated some of the concerns of rural landowners about keeping farms in the family. It does not remove issues of conveyance to others, where the tax will be due.

Those who convey a conservation easement may also reduce the value of an estate for estate tax purposes – either taking it below the exemption amount, or reducing the amount subject to taxation. Thus, the federal estate tax provides an incentive for donation of conservation easements. Elimination of the tax will eliminate this incentive. In 1997, prior to the enactment of the temporary phase-out enacted in 2001, Congress added a provision to further encourage landowners (and their heirs) to donate conservation easements. Under this provision, a conservation easement donated by the decedent, the decedent’s family, the executor of an estate, or the trustee of a trust that includes the land, not only removes that portion of the value from the taxable value of the estate, but also allows the estate to exclude from tax up to 40 percent of the remaining value of the land subject to the easement. Lands are eligible if they are within a metropolitan statistical area or within 25 miles of such an area or within 25 miles of a national park or wilderness area (unless not subject to development pressures), or if they are within 10 miles of an urban national forest. The exclusion not only operates upon the death of the decedent, but is also available to each succeeding generation if the land remains in the family of the donor.<sup>543</sup>

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<sup>542</sup> IRC 2032A.

<sup>543</sup> IRC 2031(c). The value of the exclusion is capped.

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