GROWERTALKS

Features

12/1/2024

Pay Attention to the Details

Mark E. Battersby

The owners and managers of many greenhouse businesses often complain about federal taxes. However, more often the state and local tax burden is far greater. What's worse, many of those state and local tax laws change from year to year.

Plunging revenues have prompted many state and local governments to step up their pursuit of taxes. State and local budgets—which seemingly flirt with disaster even in good times—are, in many cases, in dire straits, something with big implications for every local business. Coping with and easing the state and local tax burden means planning, beginning with the income tax.

Taxing income complexities

Today, state income taxes can cost business owners between 2.5% and almost 10%—or more—of the business' pretax income. That is not an insignificant amount, regardless of the state of the economy. Every business owner should also be aware of whether those deductions they're planning to claim on their federal tax returns will receive the same treatment at the state level. While many states follow federal tax rules, some states decouple from certain tax provisions.

Obviously, the possibility of nonconformity should always be a consideration. Although 44 states levy a corporate income tax, many greenhouse operations aren't subject to it because they're taxed as pass-through businesses where income is reported as the owner/shareholder's personal income.

Beware, state taxes are tricky. Every business faces an interesting challenge: What happens if they do business in more than one state? The state the business calls home generally wants to tax every dollar of income; every other state where it does business wants to tax income earned in their state. Does that mean paying taxes on the same income twice?

Fortunately, records and planning can ensure there are no overlooked or duplicate payments for taxable income earned in another jurisdiction and no tax bill for a greenhouse business operating as a pass-through entity such as an S corporation or partnership.

Across state lines

It's not only income taxes that differ from one taxing jurisdiction to another; there are also those cumbersome sales and use taxes. And keep in mind, that while some businesses may not be required to collect sales taxes, they often must pay them on some of their own purchases.

It's all too easy today to get caught ignoring the "use" tax due on purchases made in another taxing jurisdiction, via the internet or where sales taxes should have been collected, but weren't.

A comprehensive review of the sales and use tax rules can identify exposures, as well as revealing opportunities for refund claims and exemptions. After all, any business that doesn't have procedures in place to properly calculate and remit collected sales taxes or use taxes is at risk of underreporting and fines that vary from state to state.

Labor laws and taxes

Federal, state and even local laws dealing with employees change from year to year and all usually impact a business' annual tax bill. While many of these laws are designed to be beneficial for employees, growers are finding it increasingly difficult to remain profitable.

Many states have created programs to compensate businesses for expenses related to minimum wage law changes, worker incentive programs, such as paid family leave, and other laws dealing with employees. However, most of these are only a temporary solution and rarely address higher payroll costs and increased payroll tax bills.

Property taxes

One tax that's often overlooked and frequently overpaid is the tax assessed on the property, and in many places, the equipment and other assets of a greenhouse business. Surprisingly, few growers challenge their property tax bill. While the property tax rate can't be questioned, the assessment of the business' property—the value placed on it by the local assessor—can be challenged.

Can the growing operation be labeled as "agricultural" to qualify for a special property tax rate even though federal tax laws may differ? Does a greenhouse qualify as a "special use structure," as it does under the federal tax rules? Investigating and possibly challenging the value placed on your business' property and assets often results in savings year after year.

State tax credits and incentives

State and local governments often incentivize businesses through tax breaks, grant programs or business-friendly policies. Is your business taking full advantage of all the tax credits and incentives they qualify for?

Conducting a review of the available programs can reveal real opportunities for savings. As one example, some incentives are geographically located. A business located in an area designated by either the federal or state government, may receive benefits and special tax rates not available to those outside those areas.

A number of businesses may be eligible for a state tax credit for research and development (R&D) costs. State rules often vary drastically from the federal R& D tax credit, but few growers are aware how many costs qualify for the federal credit or the usually more expansive state R&D credit.

Other credit and incentive packages are offered by economic development agencies and usually based on economic benefits such as job creation, job retention and/or how much capital investment an applying business will bring to the area. Obviously, awareness of these programs is necessary before you can negotiate with a state economic development agency.

Potential pitfalls

The road to savings on the state and local levels contains a number of potential pitfalls, such as:

■ **Independent contractors.** Those in the horticulture industry have long appreciated the absence of payroll taxes and the withholding burdens that are associated with employees, but are non-existent with independent contractors. Many individuals favor the flexibility, freedom and perceived tax benefits as independent contractors.

Unfortunately, it's not only the IRS and the U.S. Department of Labor that are changing the definition of who is and who isn't an independent contractor. A growing number of states are adopting the controversial—and stricter—definition of independent contractors originating in California, but driving up payroll costs elsewhere.

■ **Conforming to federal tax reform.** Although slated to expire soon, the Tax Cuts and Jobs Act (TCJA) lowered the federal corporate tax rate, and made significant changes to the cost recovery possibilities and deductions available to businesses. The states have largely settled on TCJA conformity, but each year a number of taxing jurisdictions institute change or adapt specific provisions.

■ **Artificial intelligence.** In the last five years, 17 states have adopted almost 30 bills focusing on regulating artificial intelligence (AI). Any grower adopting new AI tools will face an added regulatory burden. While Congress has been slow to act, many states are passing (or have passed) their own AI laws governing technology that every business operating within its boundaries must comply with.

■ **Pass-through entities and taxes.** Pass-through entities are the hybrids of business taxation—business entities where tax liability or losses are passed onto the tax returns of the business' owner/shareholders and taxed at their personal tax rate. However, states are increasingly applying corporate income tax concepts to pass-through entities operating in more than one state, and it's often unclear how these concepts are applied in each tax jurisdiction.

Separate accounting for state taxes

While most growers take a general approach to apportioning income, many states allow the use of "separate accounting." Separate accounting is pretty much what it sounds like—a second set of books.

The grower computes the operation's net income based on the income and expenses in the state. Unless the operation in the state is almost a separate entity, this generally isn't easy. It can also be expensive. However, despite the problems, the use of separate accounting can result in significant tax savings, especially if the operations in the state produce little or no income and the state has a high tax rate.

Filing strategies

When is your business required to file a tax return in another state? Generally, if a business simply sends goods into a state and doesn't have employees working in that state, the business probably won't have to file income tax returns in that state.

Naturally, if a greenhouse business has property located in a state or has employees in a state (or some other similar connection) the operation is generally required to file tax returns and pay taxes. Not filing could result in penalties, interest and a host of other tax problems.

Keeping current

State and local taxes are varied and in constant flux. However, keeping track of your business' state and local tax obligations, while often quite complex, can be worth the effort. Failing to keep abreast can significantly affect your operation's cash flow.

A thorough review can lead to new strategies that result in lower tax bills. Properly conducted, a review of state and local tax laws—and benefit programs that may be available to your operation—may uncover opportunities for state and local tax savings, and available credits or incentives. As always, professional guidance is recommended. **GT**

Mark E. Battersby is a freelance writer who specializes in business finance. He can be reached at mebatt12@earthlink.net.