REPORT OF THE
DEPARTMENT OF TAXATION ON

THE TAXATION OF FARM WINERIES IN VIRGINIA

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

HOUSE DOCUMENT NO. 23

COMMONWEALTH OF VIRGINIA
RICHMOND
1995

COMMONWEALTH *of* VIRGINIA

Department of Taxation

January 10, 1995

TO: The Honorable George F. Allen
Governor of Virginia
and
The General Assembly of Virginia

The 1994 General Assembly, by House Joint Resolution No. 148, directed the Department of Taxation in conjunction with the Department of Agriculture and Consumer Services, and in consultation with the Department of Alcoholic Beverage Control, to study the taxation of Virginia Farm Wineries. This study arose out of concerns over the possibility of Virginia taxes placing Virginia Farm Wineries at a competitive disadvantage with wineries in other states.

Enclosed for your review and consideration is the report that has been prepared in response to this resolution.

On behalf of the Department of Taxation, I wish to express our appreciation for the cooperation and assistance provided by the Department of Agriculture and Consumer Services and the Department of Alcoholic Beverage Control.

Respectfully submitted,

Danny M. Payne
Tax Commissioner

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EXECUTIVE SUMMARY

The 1994 General Assembly directed the Department of Taxation (TAX) in conjunction with other state agencies to study the taxation of Virginia Farm Wineries. This study arose out of concerns over the possibility of Virginia taxes placing Virginia Farm Wineries at a competitive disadvantage with wineries in other states.

Study Techniques

TAX worked closely with the Wine Marketing Specialist of the Division of Marketing, Department of Agriculture and Consumer Services, and consulted with the Department of Alcoholic Beverage Control on various occasions. TAX also established a liaison with the Virginia Winegrowers Association to assist in determining concerns throughout Virginia's Farm Winery industry. TAX reviewed current department policy regarding farm wineries, taxes and fees imposed on wine by the Virginia Department of Alcoholic Beverage Control, surveyed 23 Virginia localities within which vineyards and farm wineries are located to determine local tax implications, and surveyed those states with wine industries comparable in size to Virginia's with regard to promotional efforts and incentives. The information and recommendations contained herein are based on TAX's findings with respect to trends in other states, local tax trends, and information compiled by TAX and other state agencies.

State of the Virginia Wine Industry

The Virginia Farm Winery industry has been, and continues to be, a growing part of Virginia's agriculture and commerce sectors. Virginia wines have been recognized as a high quality product both on the national and international levels. Consumption of Virginia wine by Virginians has steadily risen and state wines are also gaining popularity on the national level (Virginia has been recognized as "the most accomplished of America's emerging wine regions"). As a result of this increasing popularity and reputation, the industry has sustained a steady though modest growth in production volume. Over the past decade, on-site sales (sales at farm wineries) have risen approximately 13.2 percent annually; sales by wholesalers-distributors have risen 18 percent annually.

Over the past decade, the Virginia wine industry has emerged as a significant influence on the Virginia economy, generating investments of over $40 million and annual revenues in the neighborhood of $65 million, and employing over 1,500 people. In addition, the continued growth of the wine industry ensures total income and employment opportunities in rural areas without damaging the rural character and environmental quality of Virginia's agricultural regions.

Promotional Efforts and Return on Investment

Virginia's promotional efforts, as provided by the Virginia Winegrowers Advisory Board in conjunction with the Wine Marketing Office of the Virginia Department of Agriculture and Consumer Services, have been exemplary in nature. As expressed by a representative of another state with a wine industry similar in size to Virginia's, Virginia has become "the envy" of other states with regard to the promotion of its wines.

The Virginia wine industry not only directly contributes to the economic growth of Virginia by producing an increasingly popular product which generates revenues and acclaim for the state, but it also plays a role in promoting tourism. Surveys reveal that in contrast with the typical tourist, winery visitors tend to stay in the state longer, are more affluent, and spend twice as much money while in the state.

Taxation of Wineries

Virginia wineries, as all businesses, are subject to a number of taxes at both the state and local levels. However, farm wineries, as other agricultural producers, also enjoy considerable tax incentives in the areas of the retail sales and use tax (on their purchases of items used directly in grape/wine production), and local property taxes in certain localities. TAX found that compared with the tax treatment of wineries/wine products in other states, the only area where Virginia wines may be at a disadvantage is with respect to the liter tax imposed by the Virginia Alcoholic Beverage Control Board. The Virginia liter tax (converted to a gallonage tax for comparison with other states) is $1.51 per gallon, the fourth highest in the country. In addition, Virginia ABC imposes an additional ad valorem tax of 4% on all Virginia wines sold through its stores.

Other than the exemption from the retail sales and use tax on certain purchases, Virginia does not offer any state tax incentives to existing farm wineries or to new farm wineries seeking to locate in Virginia. With the exception of Ohio and Missouri, this is consistent with states with wine industries comparable in size to Virginia's. Ohio provides an income tax credit of 10% of total dollars invested in new vineyards; however, this is offered to help Ohio reverse a declining wine industry (by contrast, the industry has been growing in Virginia). In an effort to develop and expand its wine industry, Missouri offers a cash incentive for grape growing and also appropriates money to assist in start-up cost for new wineries.

Recommendations

Due to the generally favorable tax treatment of Virginia farm wineries as compared to other states, and the exemplary efforts and favorable comments from representatives of other states regarding the promotion of Virginia wines, widespread changes in these areas may be of little value. However, several recommendations are set out below, which could further enhance Virginia's wine industry and encourage its continuing growth:

- **Commence a dialogue between the Department of Alcoholic Beverage Control (ABC) and the wine industry on tax and licensing issues.**

  While no evidence has been presented to indicate that the 4% ad valorem tax or the $1.51 per gallon wine excise tax detrimentally impact wine production or sales in Virginia, some winegrowers expressed concern over the high taxes imposed on their products.

  A 4% ad valorem tax is imposed only on the sale of wines through Virginia ABC stores. Virginia wines are the only wine product sold by ABC. In addition, Virginia currently imposes a wine excise tax of $1.51 per gallon, the fourth highest rate in the country, on all wine sold in the state. The average wine excise tax rate per gallon for those states imposing an excise tax is 73 cents. It should be noted that the two states which produce 95% of the wine sold in the country, California and New York, impose a wine excise tax of only $.20 per gallon.

  Wineries also expressed concerns about state license taxes on commercial wineries. If a winery produces 5,000 gallons or less of wine in a year, the license tax is $350. However, if the winery produces more than 5,000 gallons of wine, the tax is $2,850 per year. A reduction in the license fee for production over 5,000 gallons, or a graduated license fee depending upon gallons produced, would reduce the financial impact of state licensure on Virginia wineries.

- **Explore opportunities for greater cooperative marketing efforts by ABC, the Virginia Winegrowers Advisory Board, and Virginia farm wineries.**

  Two options that could be considered include encouraging farm wineries to seek to have their products sold through ABC and providing for higher visibility of Virginia wines in its stores. Currently ABC carries approximately 175 wines produced by Virginia wineries. It has a semi-annual listing process whereby a wine producer can seek to have his wine approved for sale by ABC. Promotion of this process, and possibly allowing for the listing process on a more frequent basis, may increase the presence of Virginia wines in ABC stores.

  The fact that ABC stores sell Virginia wines is not very well known. Additional in-store advertising or changes in the outside signage appear to be low-cost alternatives to increasing consumer awareness of the availability of Virginia wines through such stores. While some advertising materials of this type currently are provided by the industry and some wineries, additional information could be provided.

- **Encourage localities to adopt use-value assessments for land owned by farm wineries which is used for growing grapes and producing wine.**

  "Land use" taxation is available on a local option basis -- under this concept, localities can elect to assess agricultural, horticultural, and forestal real estate at its use-value, rather than its fair market value. While localities with the greatest presence of wineries and vineyards have adopted use-value assessment for land used for growing grapes, there remain some which value the property at fair market value.

  Furthermore, localities may value the property owned by a farm winery differently - for example, the property upon which the grapes are grown may be valued at its use-value, but the property upon which the retail or manufacturing portion of the business is located may be valued at its fair market value.

  Inconsistent treatment in the area of property valuation between localities has been a source of confusion and frustration for farm wineries. Uniformity in the use of land-use assessments would help to eliminate this confusion, result in a reduction of property taxes for some wineries and possibly serve as an inducement to individuals to establish wineries in Virginia.

  Statewide application of land use taxation is an option, and is suggested in Opportunity Virginia, the Commonwealth's economic development strategic plan, as a means of stimulating the agricultural and forestry sectors. In addition, the Virginia Winegrowers Advisory Board can play a critical role in encouraging wine producing localities to adopt land use ordinances and to extend existing ordinances to include winery property.

INTRODUCTION

Pursuant to House Joint Resolution No. 148, copy attached as Appendix 1 of this report, the 1994 General Assembly requested the Department of Taxation and the Department of Agriculture and Consumer Services to study the taxation of Virginia wineries with the purpose of ensuring Virginia wineries equity with competing out-of-state wineries. The focus of the study was on how Virginia wineries and their products are taxed as compared with other states, particularly those which have a wine industry similar in size to the Commonwealth's.

The Department of Taxation, with the assistance of the Department of Agriculture and Consumer Services and the Department of Alcoholic Beverage Control, has studied the issues and its findings are presented herein. The report explains the evolution of the wine industry in Virginia, its impact on the state's economy, the various taxes to which Virginia farm wineries and their wine products are subject, and the tax treatment, at the state level, of wineries in other states. It also explains Virginia's efforts to promote its wine industry.

Findings:

1. *At the state level, Virginia taxes wineries comparable to other states except, unlike most states, Virginia provides exemptions from the retail sales and use tax for wineries and vineyards.*

2. *Virginia is tied with Georgia as having the fourth highest liter tax (wine excise tax) in the country. An additional four percent tax is imposed on top of the liter tax on sales of Virginia wines at ABC stores.*

3. *At the local level, comparison with other states' taxing schemes is difficult; however, Virginia's local taxation of farm wineries was examined to determine the actual tax burden. Overall, TAX found that a majority of the localities within which farm wineries are located:*

    - *value real property for growing grapes at land use rather than fair market value, and*
    - *exempt from local personal property taxes personal property owned by farm wineries and vineyards.*

4. *The local taxation of wineries varies from locality to locality, which creates some confusion/frustration in the industry. The industry feels that in order for the sector to make long-term commitments to growth/expansion, consistency and certainty with respect to local tax rates is needed.*

5. *Virginia's efforts to promote the wine industry generally exceed those in states with wine industries of comparable size to Virginia's.*

WINE INDUSTRY

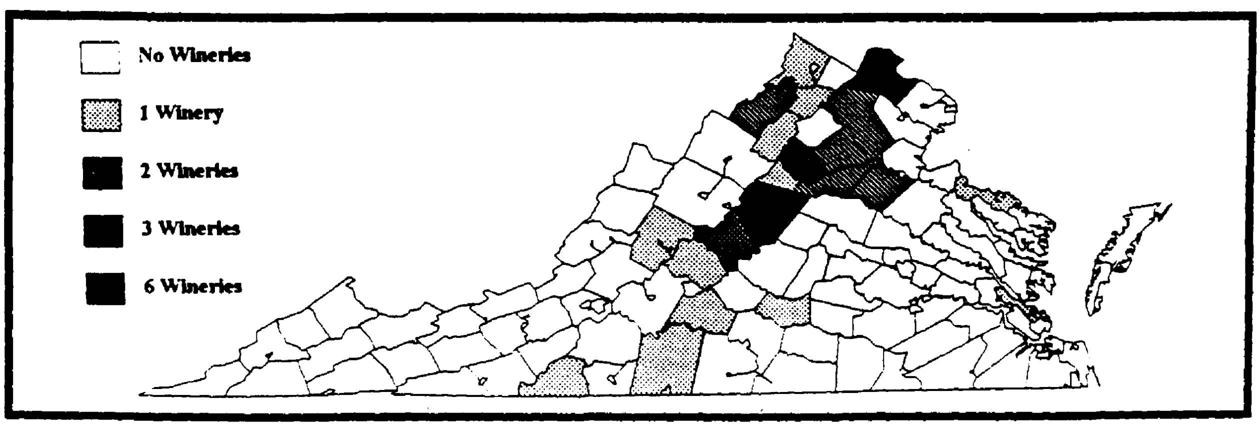
In Virginia

Generally

Virginia's soil and climate are conducive to grape growing - the state has six nationally recognized viticultural areas designated for their unique grape growing conditions. The wine industry's presence and contributions to Virginia's economy became more prevalent in 1985 after the creation of the Virginia Winegrowers Advisory Board by the General Assembly. The Board was established to "encourage the increased productivity of all phases of grape and wine production in Virginia and to provide for continuing orderly growth by sponsoring and encouraging research, education and marketing of Virginia wine."

Currently, there are approximately 45 farm wineries located in Virginia. As the following map illustrates, wineries and vineyards are located throughout the state, concentrated primarily in the Shenandoah Valley, along the Blue Ridge Mountains, the Charlottesville area, and Northern Virginia. A majority of the state's wineries are deemed to be "boutique" operations, producing between 300 and 5,000 cases a year. By comparison, the Jordan, one of the leading "estate" vineyards in California, wil bottle 50,000 cases of red wine alone in a single year.

Concentration of Wineries In Virginia



A Virginia "farm winery" is defined by statute (Code of Virginia § 4.1-100) as one where at least 75% of the grapes processed are grown in Virginia vineyards and at least 50% of the grapes are grown in vineyards owned or leased by the winery.

Virtually all of Virginia grapes are used for wine production by Virginia farm wineries. Grape production is the 16th largest agricultural commodity in Virginia, with over 3,000 tons of grapes being harvested in 1992.

By 1992, Virginia's wine sector was marketing 339,670 gallons of wine, valued at $16.5 million. Virginia wines' share of the Virginia wine market has risen from a negligible .5% in 1987 to about 4% in 1992, reflecting a greater acceptability of the wines in the state. Virginia wines are now rated comparable to other wines in price and quality and have brought home national and international awards.

With the exception of larger wineries, on average, 45% of all wine produced by farm wineries is sold either on-site or at festivals, while one-third is marketed through distributors. Virginia wine is also sold and promoted in ABC stores. Virginia wines are the only wine products sold by ABC stores. Total Virginia wine sales are increasing at an average rate of 15.6% annually.

While in 1993 Virginia wines accounted for only one-tenth of one percent of the total wine produced in the United States, they are gaining popularity and Virginia is emerging as a premium wine state. The state was recognized as "the most accomplished of America's emerging wine regions" by "The Wine Spectator" magazine.

Economic Impact

Virginia's wine industry has direct, indirect, and induced effects on the state and local economies. Farm wineries contribute directly through state and local tax revenues and indirectly by providing employment opportunities. It is estimated that the wine industry currently employs in excess of 1,500 persons. Furthermore, wineries contribute a marketable product which brings national and international recognition to Virginia and are an increasingly popular segment of the state's tourism industry. A study conducted by the Virginia Department of Tourism in 1992 revealed that five percent of the tourists who visit Virginia visit its wineries. The 1992 NFO Virginia Pleasure and Business Visitor Study Profile of Winery Visitors found that compared to the average tourist in Virginia, winery visitors tended to stay in the state longer, are somewhat more affluent, and spend twice as much money while in the state. According to The Impact of Farm Wineries on Virginia's Economy (herein referred to as "The Impact Report"), a report funded by the Virginia Winegrowers Advisory Board, the total direct, indirect, and induced effects of Virginia's wine industry translate into a $65 million-a-year industry.

Encouragement of the wine industry may be a good economic development strategy for rural areas since total income and employment opportunities may be increased without damaging the rural character and environmental quality of a region. Furthermore, with its linkages to tourism and services, the industry has the potential of attracting and sustaining both agricultural and nonagricultural employment.

Operational Costs

Generally, it takes ten years from the decision to invest for a winery to evolve to the full scale sale of wine. The investment phases include vineyard development, winery facilities development and expansion, wine maturity and inventory build-up. Many Virginia farm wineries began as vineyards selling grapes to other wineries.

Numerous factors influence capital and investment requirements, and the operational costs of a winery, including the quality of wine produced, length of fermentation process, length of aging process, degree of labor and capital intensity, etc. The Impact Report indicated that vineyards generally require approximately $12,000 per acre of improvement costs over the cost of the land itself. In addition, depending upon the sophistication of equipment used and architectural design factor, actual wine production costs can range from an additional $50 to $100 per case. Since wines require aging, wineries generally must maintain an investment in inventory of least two years of sales volume.

According to the findings of The Impact Report, for the wine sector to make long term commitments it must have:

1) as much certainty about the future as possible, including local land-use and personal property tax treatment;
2) oenological (wine making) and economic research and extension support;
3) large amounts of medium-term capital financing; and
4) continued strong marketing efforts.

National

Ninety-five percent of the U.S. wine production is in two states -- California (90%) and New York (5%). In 1993, Virginia was ranked as the eleventh largest wine producing state, notwithstanding the fact that it produced only one-tenth of one percent of the nation's total output. Other states with wine industries of similar size to Virginia's include Maryland, Michigan, Ohio, Texas, and Missouri.

Six states, California, New York, New Jersey, Illinois, Florida, and Texas, represent more than 50% of the U.S. wine consumption. The next 10 states, one of which is Virginia, represent another 25% of the total market. Virginia is also among those states with growing per capita wine consumption. Even though the trend has been for per capita consumption to decline nationally, Virginia's per capita consumption is rising. This may be the result of Virginia's continually growing tourism industry and excellent State support in the Commonwealth. Furthermore, wine consumption is on the rise compared to other alcoholic beverages. Part of the growth in its popularity may stem from recent reports over the health benefits of consuming a glass or two of red wine each day.

Wines produced by Virginia wineries are positioned in the increasing popular table (premium) wine segment of the industry. Nationally, and in Virginia, table wines are becoming more popular as the cheaper ("jug") wines, sparkling wines, dessert wines, vermouth and wine coolers are decreasing in popularity. Furthermore, consumption of imported wine is down, as a result of federal excise tax increases, currency fluctuations, and the increased popularity of wines produced in the United States.

PROMOTIONAL EFFORTS

Virginia

Virginia's wine industry is promoted in various ways by the state, but most notably through the Virginia Winegrowers Advisory Board (Board) in conjunction with the Wine Marketing Office of the Virginia Department of Agriculture and Consumer Services (VDACS). Some of the promotional programs sponsored by the Virginia Winegrowers Advisory Board include the annual Governor's Cup wine competition and reception, annual restaurant and retail awards program, the Virginia Wine Industry Person of the Year Award, designation of October as Virginia Wine Month, funding for the Virginia Wine Marketing Program which produces the "Virginia Wineries Festival and Tour Guide" and the "Vintage Virginia newsletter". The Wine Marketing Office implements these and other programs including fall and spring advertising campaigns, production of point-of-sale items each fall for wineries, restaurants and retailers, and participation in trade shows.

The Board has funded research into wine issues to assist in the development and improvement of the industry. Particularly, it has supported research by a team of scientists, led by an oenologist (one who studies winemaking) and a viticulturalist (an authority on the cultivation of grapes) to enhance the quality of the Virginia grapes. The team studies pest management, recordkeeping, and focuses on improving overall grape consistency. Their findings are shared with growers and winemakers in order to maximize the usage of the grapes. For each year of the 1995-1996 biennium, the Board has been allocated $247,179 to support its research and promotional efforts.

Efforts by ABC to promote the industry include the display and distribution of the Wineries Festival and Tour Guide through its stores and displays and exclusive sales of Virginia wines therein. ABC stores currently sell approximately 170 varieties of wine from 25 Virginia wineries. However, due to space limitations and other factors, each store does not stock all 170 varieties. Other efforts by the state to promote the industry include reference to the wine industry in the state map and grape logo highway signs which are posted within a 10 mile radius of all Virginia wineries.

The wine industry does much to promote itself as well, through various associations.

Other States

Based on the results of a survey of other states with wine industries similar in size to Virginia's, the promotional efforts of the Virginia Winegrowers Advisory Board, in conjunction the Wine Marketing Office, are comparable, if not exceptional, to the promotional programs of the states surveyed.

The findings of the survey also revealed that two states, Ohio and Missouri, offer tax and monetary incentives to encourage growth in their states' wine industries:

- Ohio provides investors in vineyards an income tax credit of 10 percent of total dollars invested to be carried forward for seven years. The credit may be taken either on a corporate income tax return or an individual income tax return depending on how the investment is made. The credit is Ohio's effort to encourage agriculture growth in the form of vineyards, which (unlike Virginia) decreased substantially from 7,000 acres in 1971 to approximately 2,200 acres under cultivation today.

  Ohio anticipates offering a similar type of tax credit to those same investors who continue to make investments with the intention of establishing a winery located at the vineyard after the seven-year credit has expired. However, such a credit is not currently provided under Ohio law.

- Missouri has a great interest in not only expanding the state's agricultural production of grapes, but also expanding the production of Missouri produced wines. In an effort to expand these areas within the state, Missouri provides a cash incentive for grape growing and also a cash incentive to be applied to start-up cost for new wineries.

TAXATION OF WINERIES

Wineries are subject to a variety of taxes at both the state and local level. The following explains the various taxes and how they are applicable to Virginia vineyards and farm wineries.

State Taxes

At the state level, like virtually all businesses, vineyards and farm wineries are subject to income taxes, license taxes, unemployment taxes, and workers' compensation and withholding requirements. However, wineries and vineyards generally are entitled to exemptions from the retail sales and use tax on their purchases of tangible personal property used in the growing of grapes and the manufacture of wine.

Although not paid directly by farm wineries, sales of wine are subject to excise taxes and the retail sales and use tax.

Income Taxes

Vineyards and farm wineries are subject to state income taxes, either individual or corporation, depending upon how they are structured. The tax rate for corporations is 6% and the top tax rate for individual income tax is 5.75%. The state's income tax rates have not been raised since 1972 and have increased only once since 1948.

Sales and Use Taxes

Except for structural construction materials to be affixed to real property, vineyards and Virginia farm wineries are entitled to an exemption from the retail sales and use tax pursuant to Code of Virginia § 58.1-609.2(1) for all tangible personal property necessary for use in agricultural production for market. Items exempt from the tax include, but are not limited to, machinery and tools, containers for the grapes, the vines themselves, pesticides, and wire and lumber used to trellis the vines.

Farm wineries are entitled to the industrial processing/manufacturing exemption from the tax found in Code of Virginia § 58.1-609.3(1) on their purchases of grapes from vineyards, machinery and tools or repair parts therefor or replacements thereof, fuel, power, energy or supplies used directly in the production of wine. They are also entitled to an exemption on containers, labels, and boxes, for packaging the wine for shipment or sale.

As Table 1 illustrates, of the states which impose a retail sales and use tax, only 15, including Virginia, provide exemptions from the tax for farm wineries and vineyards. Of the 13 states with wine industries of comparable size to Virginia's (highlighted in the table), 11 provide similar exemptions from the tax. It is interesting to note that the country's largest wine producer, California, does not provide a similar exemption.

Retail sales of wine, as well as distilled spirits and beer, are subject to the retail sales and use tax in Virginia and in the vast majority of other states which impose a retail sales and use or similar type excise tax. Only two states, Kansas and Vermont, do not subject sales of alcoholic beverages to the sales tax.

TABLE 1
SALES & USE TAX TREATMENTS (PURCHASES)

State	Wineries Exemption	Vineyards Exemption	State	Wineries Exemption	Vineyards Exemption
Alabama	N	N	Nevada	N	N
Arizona	N	Y[1]	New Jersey		
Arkansas	N	N	Mew Mexico	N	N
California	N	N	New York	Y	Y
Colorado	N	N	N. Carolina	N	N
Connecticut	Y	Y[2]	N. Dakota	N	N
D.C.	N	N	Ohio	Y	Y
Florida	N	N	Oklahoma	Y	Y
Georgia	N	N	Pennsylvania	Y	Y
Hawaii	N	N	Rhode Island	Y	Y
Idaho	Y	Y	S. Carolina	Y	N
Illinois	N	N	S. Dakota	N	N
Indiana	Y	Y	Tennessee	Y	Y[4]
Iowa	N	N	Texas		
Kansas	N	N	Utah	None	
Kentucky	N	N	Vermont	Y	Y
Louisiana	Y	Y	VIRGINIA	Y	Y
Maine	N	N	Washington	N	N
Maryland	Y	Y	W. Virginia	Y[5]	Y[6]
Massachusetts	Y	Y	Wisconsin	Y	Y
			Wyoming	N	N
Michigan	Y[3]	Y[3]			
Minnesota	Y	Y			
Mississippi	N	N			
Missouri	Y	Y			
Nebraska	N	N			

Notes:

Y = Yes
N = No

1 Exemption limited to machinery or equipment used directly in manufacturing.
2 Exempt provided gross income from sales of agricultural products in the preceding calendar year were not less than $2,500.
3 Exempt provided it is used to produce a product for sale.
4 Exempt only to the extent that it qualifies as industrial machinery.
5 Exempt when used in the commercial production of an agricultural product.
6 Exempt when items are used directly in manufacturing.

Excise Taxes

While wineries themselves are not subject to excise taxes, an excise tax is imposed on each liter of wine sold in Virginia. Pursuant to Code of Virginia § 4.1-234, an excise tax equal to forty cents is imposed on each liter of wine sold in Virginia. An additional four percent tax is imposed only on vermouth and wine produced by Virginia farm wineries and sold to consumers through ABC stores. Virginia wines are the only wine products sold by ABC.

The 4% additional tax was enacted in 1980 when legislation establishing a uniform liter tax for both fortified (greater than 14% alcohol content) and unfortified wine (less than 14% alcohol content) was passed by the General Assembly. Prior to 1980, the excise tax on fortified wine was greater than the tax on unfortified wine, presumably due to the higher alcohol content. The 4% tax was enacted to make up for any lost revenues resulting from the change in the excise tax structure. This tax, the beer and beverage excise tax and the state tax on distilled spirits are distributed to the Commonwealth's general fund. The wine liter tax is distributed according to the following formula: 44% is distributed to localities on the basis of general population, 44% is distributed to the general fund, and 12% is distributed to ABC for operating expenses.

All states impose excise taxes on sales of wine and other alcoholic beverages. Table 2 illustrates the wine excise tax rates imposed by the various states. For comparison purposes, the liter tax has been converted to a gallonage tax. As the table illustrates, Virginia is tied with Georgia as having the fourth highest gallonage tax in the country. It is important to note, however, that the different states may impose different gallonage taxes depending upon the alcohol content of the wine, whereas, Virginia imposes the same gallonage tax on all wines except for those under four percent alcohol content (wine coolers). Of those states with similarly sized regional wine industries (highlighted in the table), only one state, Iowa, has an excise tax higher than Virginia's. The remaining similar states have substantially lower excise tax rates.

While wine producers complained about the high excise taxes on wine, no evidence exists to illustrate that they impede the growth of the industry.

Local Taxes

Farm wineries may be subject to a variety of taxes at the local level in Virginia - real property; personal property; merchants' capital; Business, Professional, Occupational and License (BPOL); machinery and tools; and other local license taxes. However, in several instances, like other agricultural producers, they are afforded some preferential tax treatment. Wineries in other states are also subject to similar taxes, however, due to the disparity in rates and tax treatments, a comparison of all other states' local tax rates and structures was beyond the scope of this study.

TABLE 2
WINE EXCISE TAXES[1]

State	Rate	State	Rate
Florida	2.25	Maine	.60
Iowa	**1.75**	Vermont	.55
Alabama	1.70	**Massachusetts**	**.51**
Georgia	1.51	**Michigan**	**.50**
Virginia	**1.51**	Kentucky	.50
Hawaii	1.30	N. Dakota	.50
Tennessee	1.10	**Indiana**	**.47**
Montana	1.06	**Idaho**	**.45**
West Virginia	1.00	Colorado	.43
New Mexico	**.95**	Nevada	.40
S. Dakota	.93	**Maryland**	**.40**
Delaware	.90	**Missouri**	**.35**
S. Carolina	.90	Mississippi	.35
Washington	.87	Kansas	.30
Alaska	.85	D.C.	.30
Arizona	.84	Minnesota	.30
N. Carolina	.79	**Ohio**	**.26**
Arkansas	.75	**Wisconsin**	**.25**
Nebraska	.75	Illinois	.23
Oklahoma	.72	California	.20
New Jersey	.70	**Texas**	**.20**
Oregon	.67	New York	.20
Connecticut	.60	Louisiana[2]	.19

Notes:

1 Per gallon

2 **Pennsylvania**, New Hampshire, Utah and Wyoming - all wine sales are through state-operated stores. Revenue is generated from various taxes, fees and profits.

Real Property Taxes

Real estate owned by farm wineries is subject to real property taxes imposed by localities. As illustrated in Table 3, the tax rates and the basis for the tax assessment, vary from locality to locality. Assessments for real property taxation generally are based on the fair market value of all taxable real estate. Fair market value is determined by an appraisal process which may occur as frequently as annually or as infrequently as once every six years.

However, Virginia law, specifically Article 4 (§§ 58.1-3229 et. seq) of Chapter 32 of Title 58.1 of the Code of Virginia provides for the valuation of certain property based upon its usage rather than upon its fair market value. In 1971, the General Assembly passed legislation, effective July 1, 1973, to allow for land-use assessments in order to preserve land dedicated to agricultural, forestal, and open space uses by reducing or deferring the increased taxes due to a potential "higher use," by reducing the pressure the increasing taxes may play in a landowner's decision to sell or convert such property to a more intensive use.

In order to provide for land-use assessments, a locality must adopt a jurisdiction-wide ordinance that permits the appraisal or valuation of the real estate accordingly. However, property located within an agricultural, horticultural, or forestal district established pursuant to Chapter 36 (§ 15.1-1506 et. seq) of Title 15.1 of the Code of Virginia, may be valued according to use values instead of fair market value regardless of whether the locality within which it is located has adopted a land-use ordinance. To be eligible for land use assessments, acreage allocated for the specific use must be at least 5 acres and must have been used for this purpose for 5 or more consecutive years.

Accordingly, real property owned by a farm winery may be subject to a use value assessment, rather that at its fair market value if the locality within which it is located has adopted an ordinance for land use assessment. Furthermore, under Code of Virginia § 58.1-3236, localities may value the property owned by a winery differently - for example, the property upon which the grapes are grown may be valued at its land use value, but property upon which the retail or manufacturing portion of the business is located is valued at its fair market value. As illustrated in Table 3, 14 of the 23 localities within which wineries are located assess property owned by wineries at land use value, whereas nine localities assess such property at fair market value.

Personal Property Taxes

Personal property owned by a farm winery may be taxed only at the local level. While required to value property at fair market value, localities have been given the statutory authority to value each class of tangible personal property according to a different method as long as they are uniform in their approach. However, all property within a particular classification must be taxed at the same rate. The different classifications of property give localities a certain amount of choice in selecting, for economic development or other policy reasons, the types of businesses that can be taxed at a rate lower than the normal tangible personal property tax rate or exempted from the tax altogether.

Farm machinery and farm implements, including equipment and machinery used by farm wineries in the production of wine, and wine produced by farm wineries in the hands of a producer, may be exempted in whole or in part from taxation, or taxed at a different rate pursuant to Code of Virginia § 58.1-3505. TAX has found that a majority of localities within which farm wineries or vineyards are located exempt personal property of farm wineries from the tax. *See* Table 3. Machinery and tools used by wineries are excluded from the machinery and tools tax provided for in Code of Virginia § 58.1-3507 but are included in the classification of farm machinery for purposes of personal property taxes.

As explained in the State Taxes section, a majority of the purchases of tangible personal property by wineries or vineyards are exempt from the retail sales and use tax provided the property is used in the production of grapes or in the manufacture of wine.

BPOL/Merchants' Capital Tax

In many localities, farm wineries are subject to local business license (BPOL) or merchants' capital taxes. Localities may impose the BPOL tax or a merchants' capital tax, but not both. Whenever a local jurisdiction imposes a BPOL tax, the basis for the tax generally is gross receipts. The merchants' capital tax is assessed on inventory of stock on hand and all other tangible personal property of any kind except (i) money on hand and on deposit and (ii) tangible personal property not offered for sale as merchandise (which is taxed as tangible personal property). The merchants' capital tax by law may not exceed the rate which was in effect in the locality on January 1, 1978. More counties levy the merchants' capital tax, while cities and towns typically opt to levy the BPOL tax on businesses, professions and occupations.

As illustrated in Table 4, of the 23 localities surveyed, seven subject farm wineries to the BPOL tax, nine subject them to merchants' capital tax, and seven do not subject them to either tax. Governor Allen has proposed the phase-out of the BPOL tax over a five-year period between 1996 and 2000.

Other Local Taxes

Festival tax - Pursuant to their authority to levy license taxes on businesses, trade, professions, occupations, etc., localities may also impose a license tax on carnivals, and similar events, including wine festivals. However, the extent to which such taxes are imposed is unknown. (Code of Virginia § 58.1-3728)

Admissions tax - Cities and towns may impose an admissions tax without limitation under their general taxing powers provided under the Uniform Charters Powers Act. The right to levy an admissions tax has been granted to only a few counties by general law. None of the counties within which a winery is located may levy an admissions tax. Such a tax could be applicable to admission charges to wine festivals.

Thirty-seven states tax admissions at the state level in a manner similar to that in which Virginia's localities tax admissions at the local level. Ohio and Pennsylvania have local admissions taxes only, much like the tax in Virginia.

TABLE 3
LOCAL PROPERTY TAXES FOR FARM WINERIES

Locality	Real Estate Taxes		Personal Property Taxes On Farm Machinery, Etc.	
	Basis[1]	Rate/$100	Status	Rate/$100
Albemarle	Land Use	.72	Exempt	
Amherst	FMV	.51	Exempt	
Appomattox	FMV	.70	Exempt	
Culpeper	FMV	.74	Exempt	
Fauquier	Land Use	1.03	Exempt	
Floyd	FMV	.82	Exempt	
Frederick	Land Use	.55	Exempt	
Greene	FMV	.78	Exempt	
James City	Land Use	.83	Exempt	
Loudon	Land Use	1.02	Exempt	
Madison	Land Use	.65	Taxable	8.50[2]
Nelson	Land Use	.69	Exempt	
Orange	FMV	.65	Taxable	5.50[3]
Page	Land Use	.54	Taxable	.30[4]
Patrick	FMV	.56	Taxable	4.20[5]
Pittsylvania	Land Use	.49	Exempt[6]	
Prince Edward	FMV	.59	Exempt	
Rappahannock	Land Use	.69	Exempt	
Rockbridge	FMV	.65	Exempt	
Shenandoah	Land Use	.70	Exempt[7]	
Spotsylvania	Land Use	.86	Exempt	
Stafford	Land Use	1.08	Exempt	
Westmoreland	Land Use	.86	Taxable	1.50 Farm[8] 2.50 Wine

Notes:

FMV = Fair Market Value

1 Basis is not necessarily for all land owned by a farm winery. Land upon which grapes are grown may be taxed at land-use but land upon which the actual wine-making or retail operations are located may be taxed at fair market value.

2 Assessment ratio = 20 percent of original cost

3 Assessment ratio = 20 percent of original cost first year; 5 percent each subsequent year

4 Taxed at a reduced (agricultural) rate

5 Assessment ratio = 30 percent

6 Machinery used in winemaking is taxable at $7.25 per $100; assessment ratio = 30 percent of fair market value

7 Machinery used in winemaking is taxable at $1.64 per $100

8 Farm equipment and winemaking equipment are taxed at the indicated rates

TABLE 4
LOCAL LICENSE TAXES FOR FARM WINERIES

Locality	Type of Tax (BPOL or Merchants' Capital)	Rate
Albemarle	BPOL	$1,000 if production> 5,000 gallons/yr.
Amherst	n/a	
Appomattox	MC	$1.00 per $100 of inventory on hand - ratio = 85%
Culpeper	MC	$1.64 per $100 of inventory on hand - ratio = 40%
Fauquier	BPOL	$20 for 1st $10,000 gross receipts; $.10/$100 over
Floyd	MC	$3.50 per $100 of inventory on hand - ratio = 15%
Frederick	BPOL	$500 if production > 5,000 gallons/yr.
Greene	n/a	
James City	BPOL	$.20 per $100 of inventory on hand
Loudon	n/a	
Madison	MC	$4.30 per $100 of inventory on hand - ratio = 20%
Nelson	BPOL	$30 per year
Orange	MC	$.40 per $100 of inventory on hand - ratio = 100%
Page	BPOL	$150 on retail business
Patrick	MC	$3.50 per $100 of inventory on hand - ratio = 30%
Pittsylvania	MC	$2.75 per $100 of inventory on hand - ratio = 30%
Prince Edward	MC	$.70 per $100 of inventory on hand - ratio = 100%
Rappahannock	n/a	
Rockbridge	BPOL	$.23 per $100 of inventory on hand
Shenandoah	MC	$.60 per $100 of inventory on hand - ratio = 60%
Spotsylvania	n/a	
Stafford	n/a	
Westmoreland	MC	$.50 per $100 of inventory on hand - ratio = 100%

Notes:

BPOL = Business, professional, and occupational license
MC = Merchants' Capital
n/a = No retail outlet on premises

State and Local Taxes

License Taxes

Wineries are subject to alcoholic beverage license taxes at the state level and may be subject to such taxes at the local level. The tax on the state license for each winery depends upon the amount of wine manufactured. If the winery is to manufacture 5,000 gallons or less of wine in a year, the tax is $350. However, if the winery is to manufacture more than 5,000 gallons of wine, the tax is $2,860. (Code of Virginia § 4.1-231. There are approximately 10 commercial wineries in the state subject to the higher license fee.

Pursuant to Code of Virginia § 4.1-207, farm wineries must obtain a license from the ABC Board. This license allows them to:

1) manufacture wine containing 14% or less of alcohol by volume and ship such wine;
2) sell at retail at the places of business designated on the licenses, which may include no more than two additional retail establishments of the licensee; and
3) sell wine for on-premises consumption or in closed packages for consumption off premises.

The license fee for the above is $145 per year. (Code of Virginia § 4.1-231) Furthermore, the winery must file an application for the license and pay an application fee of $50. (Code of Virginia § 4.1-230)

Pursuant to Code of Virginia § 4.1-233, the governing body of each locality may provide by ordinance for the issuance of licenses, and to charge and collect license taxes from persons licensed by the Alcoholic Beverage Control Board to manufacture, bottle or sell alcoholic beverages within such locality. The annual local license tax, however, may not exceed $1,000 for each winery license. The extent to which localities impose this license tax is unknown.

Other Direct and Indirect Taxes

Farm wineries, like other agricultural producers and small businesses, are generally subject to unemployment taxes and workers' compensation requirements (if they have more than two full-time employees). They are subject to federal and state income tax withholding requirements, the employer share of Social Security and Medicare taxes (7.65%), and must withhold or pay the employee's portion of the taxes. Furthermore, they are subject to federal and state unemployment taxes.

In addition, farm wineries must comply with state and federal labor standards and local zoning requirements/building codes.

Finally, sales of wine are subject to federal excise taxes.

CONCLUSION

Vineyards and farm wineries are subject to numerous taxes in Virginia, much like other businesses. However, in some instances they have been granted preferential tax treatment, particularly in some localities where their real property is taxed at a lower, land-use value and their personal property is exempt from personal property taxes. In addition, many localities do not exercise their authority to impose certain other taxes (i.e., the festivals tax) on wineries and wine-related events. However, while many localities may have granted preferential tax treatment to wineries, the inconsistent treatment among the localities is of concern to the wineries. They point out that in order for them to commit to expansion, there must be some certainty/stability with respect to local tax rates/treatments.

At the state level, Virginia, unlike most states, provides an exemption from the retail sales and use tax for purchases for use by vineyards and farm wineries in growing grapes and producing wine.

Although Virginia is very competitive with other states in terms of its tax treatment of wineries, one area where it is less competitive is the wine excise tax. There, Virginia has the fourth highest tax in the country. In addition to this excise tax, Virginia imposes a four percent tax on Virginia wine and vermouth sold through ABC stores.

Compared to states with similarly-sized regional wine industries, Virginia's overall efforts to promote and support the wine industry, primarily through efforts of the Virginia Winegrowers Advisory Board, generally are greater and have received high acclaim from other states whose representatives have visited Virginia to learn more about its programs.

RECOMMENDATIONS

Due to the generally favorable tax treatment of Virginia farm wineries as compared to other states, and the exemplary efforts and favorable comments from other states regarding the promotion of Virginia wines, widespread changes in these areas may be of little value. However, several recommendations are set out below, which could further enhance Virginia's wine industry and encourage its continuing growth:

♦ **Commence a dialogue between the Department of Alcoholic Beverage Control (ABC) and the wine industry on tax and licensing issues.**

  While no evidence has been presented to indicate that the 4% ad valorem tax or the $1.51 per gallon wine excise tax detrimentally impact wine production or sales in Virginia, some winegrowers expressed concern over the high taxes imposed on their products.

A 4% ad valorem tax is imposed only on the sale of wines through Virginia ABC stores. Virginia wines are the only wine product sold by ABC. In addition, Virginia currently imposes a wine excise tax of $1.51 per gallon, the fourth highest rate in the country, on all wine sold in the state. The average wine excise tax rate per gallon for those states imposing an excise tax is 73 cents. It should be noted that the two states which produce 95% of the wine sold in the country, California and New York, impose a wine excise tax of only $.20 per gallon.

Wineries also expressed concerns about state license taxes on commercial wineries. If a winery produces 5,000 gallons or less of wine in a year, the license tax is $350. However, if the winery produces more than 5,000 gallons of wine, the tax is $2,850 per year. A reduction in the license fee for production over 5,000 gallons, or a graduated license fee depending upon gallons produced, would reduce the financial impact of state licensure on Virginia wineries.

- **Explore opportunities for greater cooperative marketing efforts by ABC, the Virginia Winegrowers Advisory Board, and Virginia farm wineries.**

Two options that could be considered include encouraging farm wineries to seek to have their products sold through ABC and providing for higher visibility of Virginia wines in its stores. Currently ABC carries approximately 175 wines produced by Virginia wineries. It has a semi-annual listing process whereby a wine producer can seek to have his wine approved for sale by ABC. Promotion of this process, and possibly allowing for the listing process on a more frequent basis, may increase the presence of Virginia wines in ABC stores.

The fact that ABC stores sell Virginia wines is not very well known. Additional in-store advertising or changes in the outside signage appear to be low-cost alternatives to increasing consumer awareness of the availability of Virginia wines through such stores. While some advertising materials of this type currently are provided by the industry and individual wineries, additional information could be provided.

- **Encourage localities to adopt use-value assessments for land owned by farm wineries which is used for growing grapes and producing wine.**

"Land use" taxation is available on a local option basis -- under this concept, localities can elect to assess agricultural, horticultural, and forestal real estate at its use-value, rather than its fair market value. While localities with the greatest presence of wineries and vineyards have adopted use-value assessment for land used for growing grapes, there remain some which value the property at fair market value.

Furthermore, localities may value the property owned by a farm winery differently - for example, the property upon which the grapes are grown may be valued at its use-value, but the property upon which the retail or manufacturing portion of the business is located may be valued at its fair market value.

Inconsistent treatment in the area of property valuation between localities has been a source of confusion and frustration for farm wineries. Uniformity in the use of land-use assessments would help to eliminate this confusion, result in a reduction of property taxes for some wineries and possibly serve as an inducement to individuals to establish wineries in Virginia.

Statewide application of land use taxation is an option, and is suggested in Opportunity Virginia, the Commonwealth's economic development strategic plan, as a means of stimulating the agricultural and forestry sectors. In addition, the Virginia Winegrowers Advisory Board can play a critical role in encouraging wine producing localities to adopt land use ordinances and to extend existing ordinances to include winery property.

APPENDIX 1

GENERAL ASSEMBLY OF VIRGINIA -- 1994 SESSION

HOUSE JOINT RESOLUTION NO. 148

Requesting the Department of Taxation and the Department of Agriculture and Consumer Services to study the taxation of Virginia wineries.

Agreed to by the House of Delegates, March 10, 1994

Agreed to by the Senate, March 8, 1994

WHEREAS, the wine production industry has been a growing industry during the past decade in the Commonwealth; and

WHEREAS, it is to the benefit of the Commonwealth and its citizens for the wine production industry to remain here and to continue to grow; and

WHEREAS, the wine industry is and wine products are subject to a variety of taxes in the Commonwealth; and

WHEREAS, there is some concern about whether these taxes are so burdensome as to affect how competitive Virginia wineries are with out-of-state wineries; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Department of Taxation and the Department of Agriculture and Consumer Services, be requested to study the basis on which Virginia wineries are taxed with the purpose of ensuring Virginia wineries equity with competing out-of-state wineries. The Department of Taxation shall consult with the Department of Alcoholic Beverage Control in conducting this study.

The study shall focus on how Virginia wineries and their products are taxed as compared to other states, particularly on those states which have a wine industry similar in size to the Commonwealth's.

The Department of Taxation and the Department of Agriculture and Consumer Services shall complete the study in time to submit their findings and recommendations to the Governor and the 1995 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.