The Taxation of Agriculture in Washington State

SENATE WAYS AND MEANS COMMITTEE
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TAXATION OF AGRICULTURE
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Taxation of Agriculture

I. Summary

Agricultural land is subject to current use valuation for property tax purposes, and agricultural products, growing crops, and nursery stock are exempt from property tax. Agricultural machinery and equipment is exempt from the state property tax.

Agricultural producers are exempt from business and occupation (B&O) taxes on the growing, producing, and harvesting of agricultural products and on the wholesale sale of agricultural products. B&O taxes apply to their retail sales and to any manufacturing of agricultural products. However, agricultural-related activities, like certain food processing (manufacturing), are eligible for preferential B&O tax rates.

Many agricultural purchases are exempt from sales and use taxes and include purchases of livestock, purchases of feed, seed, fertilizer, and pesticides, purchases of animal pharmaceuticals, purchases of materials and supplies used in packing horticultural products, and purchases of certain machinery, equipment, and structures used to reduce field burning. In addition, the retail sale of agricultural products is exempt from sales and use tax if sold as food for human consumption.

While not applicable to farmers, there are exemptions available to agriculture-related manufacturers. New or replacement manufacturing machinery and equipment is exempt from sales and use taxes. The construction or expansion of manufacturing structures in rural counties is exempt from sales and use taxes. Beginning July 1, 2007, fruit and vegetable processing, cold storage warehousing of fruits and vegetables, and related research and development businesses may defer sales and use taxes on buildings, machinery and equipment, and installation labor, which need not be repaid if the business maintains operations for 8 years.

II. Property Tax

A. Land

Agricultural land may be taxed based on it current use value rather than its highest and best use value under the open space agricultural land program. Current use valuation is also available for the land under a principal residence of a farmer and housing for employees if on contiguous property for farms over 20 acres. Const. Article VII, section 11. RCW 84.36.020(2)(d).

B. Agricultural Product Exemptions

1. Agricultural and Horticultural Products

Agricultural and horticultural products of farmers are exempt from property taxes. This includes products of animal husbandry. RCW 84.36.470. They are also exempt as a business inventory under RCW 84.36.477.

2. Growing Crops

Growing crops are exempt from property taxes. RCW 84.40.030(3). Few crops are actually growing on the January 1st assessment date. This exemption provides parity for those that are.

3. Nursery Stock

Nursery stock that is grown in pots or bags is exempt from property taxes. RCW 84.40.220. This provides parity with products grown in the ground. It is also exempt as a business inventory under RCW 84.36.477.

C. Machinery & Equipment Exemptions

Machinery & equipment owned by a farmer and used exclusively to grow agricultural products are exempt from the state property tax. Local property taxes continue to apply. RCW 84.36.630.

III. B&O Tax

A. Exemptions

1. Agricultural Production and Packaging

The growing, producing, and harvesting of agricultural products is not considered manufacturing for purposes of the B&O tax. In addition, the packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage, is not considered manufacturing. RCW 82.04.120. The production by farmers of agricultural products owned by others, such as custom feed operations, are exempt from B&O taxes. RCW 82.04.330.

Because the sale at wholesale of agricultural products by farmers is exempt from B&O taxes under RCW 82.04.330, farmers who perform these activities on their own agricultural products are not subject to B&O tax (both manufacturing and wholesaling) with respect to wholesale sales of their agricultural products. They are also exempt from B&O taxes (both manufacturing and wholesaling or retailing) on out-of-state sales of their agricultural products. Persons who pack agricultural products for others are subject to B&O tax; however, a B&O tax

deduction is allowed under RCW 82.04.4287 for amounts received for washing, sorting, and packing fresh perishable horticultural products for farmers.

2. Fruit & Vegetable Processing

The canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables and the selling at wholesale fresh fruits and vegetables canned, preserved, frozen, processed, or dehydrated by the seller and sold to purchasers who transport in the ordinary course of business the goods out of this state is exempt from B&O taxes. RCW 82.04.--- (2005 c 513 s 1). As proof of sale to a person who transports in the ordinary course of business goods out of this state, the seller must annually provide a statement in a form prescribed by the department and retain the statement as a business record.

3. Seafood Processing

The cutting, grading, or ice glazing of seafood which has been cooked, frozen, or canned out of state is not considered manufacturing. RCW 82.04.120. Thus, seafood processors who perform these activities on their own seafood are exempt from B&O taxes (both manufacturing and wholesaling or retailing B&O taxes) on out-of-state sales. They are subject to wholesaling or retailing B&O taxes on in-state sales of processed seafood. Persons performing these activities for others would be subject to B&O tax.

4. Hay & Alfalfa Cubing

The cubing of hay and alfalfa is not considered manufacturing. RCW 82.04.120. This is exempt when performed by the farmer as agricultural production. Farmers who cube their own hay or alfalfa are not subject to B&O tax on this activity or upon wholesale sales of cubed hay. Persons who cube hay or alfalfa for others are taxed under the service and other activities B&O tax classification if done on the farmer's land (farming for hire) and the wholesaling classification if the cubing is performed away from the farmer's land.

5. Fish Cleaning

The removal of the head, fins, or viscera of fresh-water fish without further processing is exempt from B&O taxes. RCW 82.04.2403.

6. Conditioned Seed Sales

The sale of conditioned seed to farmers and the conditioning of seed of others for planting is exempt from B&O taxes. RCW 82.04.331 and 82.04.120. Seed includes potatoes and other agricultural seeds. It does not include flower seeds or propagative portions of plants used to grow bushes, shrubs, or trees.

7. Wholesale Sales

Wholesale sales by farmers of agricultural products, including Christmas trees and products of animal husbandry, are exempt from B&O taxes. RCW 82.04.330.

8. Wholesale Purchases and Sales of Grain

The buying and selling at wholesale sale of un-manufactured wheat, oats, barley, dry peas, dry beans, lentils, and triticale are exempt from B&O taxes. RCW 82.04.332.

9. Processed Hop

Sales of hops by hop growers & dealers that are processed into extract, pellets, or powder and are shipped outside the state for first use is exempt from B&O taxes. RCW 82.04.337.

10. Hatching Eggs or Poultry Production & Sale

Production and sale of hatching eggs or poultry for use in producing poultry or poultry products for sale is exempt from B&O taxes. RCW 82.04.410.

B. Deductions

1. Horticultural Packaging

A deduction from the B&O tax is allowed for amounts received for washing, sorting, & packing fresh perishable horticultural products for farmers, including amounts paid for materials and supplies. RCW 82.04.4287.

2. Agricultural Loan Interest

A deduction from the B&O tax is allowed for amounts received as interest on loans to farmers, ranchers, and their cooperatives by institutions owned by their members and engaging solely in making loans to farmers, ranchers, and their cooperatives. RCW 82.04.4294.

3. Cattle-Related Processing

A deduction from the B&O tax is allowed for amounts received for: (a) Slaughtering cattle if the taxpayer sells the slaughtered cattle at wholesale; (b) Breaking or processing perishable beef products derived from cattle slaughtered by the taxpayer and sold at wholesale; (c) Wholesale sales of perishable beef products derived from cattle slaughtered by the taxpayer; (d) Processing nonperishable beef products derived from cattle slaughtered by the taxpayer and sold at wholesale only; and (e) Wholesale sales of nonperishable beef products

derived from cattle slaughtered by the taxpayer. The deduction is effective until December 31, 2007, or the bans on the importation of beef and beef products from the United States by Japan, Mexico, and the Republic of South Korea have all been lifted. RCW 82.04.4335.

C. Preferential Tax Rates For Agricultural Activities

1. Manufacturing Rate of 0.138% Instead of 0.484%

a. Flour and Oil

A B&O tax rate of 0.138% applies to manufacturing wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil or products, and sunflower seeds into sunflower oil. RCW 82.04.260(1)(a).

b. Seafood

A B&O tax rate of 0.138% applies to manufacturing seafood products that remain in raw, raw frozen, or raw salted state when completed. RCW 82.04.260(1)(b).

c. Dairy Products

A B&O tax rate of 0.138% applies to manufacturing dairy products and by-products. RCW 82.04.260(1)(c).

d. Dry Peas

A B&O tax rate of 0.138% applies to dry pea splitting or processing. RCW 82.04.260(2).

e. Meats

A B&O tax rate of 0.138% applies to slaughter, breaking, and processing of perishable meat and its wholesale sale. RCW 82.04.260(4).

2. Service Rate of 0.484% Instead of 1.5%

a. Cold Storage Warehouse.

A B&O tax rate of 0.484% applies to the operation of a cold storage warehouse used to store fresh and/or frozen perishable fruits or vegetables, meat, seafood, dairy products, or fowl at a temperature to maintain the quality of the product for orderly marketing. RCW 82.04.280(4).

IV. Litter Tax Exemptions

The litter tax does not apply to sales at wholesale by farmers that are exempt from the B&O tax. RCW 82.19.050.

V. Retail Sales & Use Tax Exemptions

A. Agricultural Sales

1. Food

The sales of food for human consumption is exempt from sales tax, whether made by a farmer or otherwise. RCW 82.08.0293 and 82.12.0293.

2. Pollen

The sale of pollen is exempt from sales and use taxes. RCW 82.08.0277 and 82.12.0273.

B. Agricultural Purchases

1. Livestock

a. Livestock & Cattle

The sale of livestock used for breeding purposes and cattle & milk cows used on a farm are exempt from sales and use taxes. RCW 82.08.0259 and 82.12.0261.

b. Poultry

The sale of poultry for use in producing poultry or poultry products for sale is exempt from sales and use taxes. RCW 82.08.0267 and 82.12.0262.

c. Semen

The sale of semen for artificial insemination of livestock is exempt from sales and use taxes. RCW 82.08.0272 and 82.12.0267.

2. Agricultural Inputs (Consumables)

a. Horticultural Services Provided to Farmers

Horticultural services provided to farmers are exempt from sales and use taxes. This includes the cultivation of vegetables, fruits, grains, field

crops, ornamental floriculture, and nursery products and includes soil preparation, crop cultivation, and harvesting services. RCW 82.04.050(3)(e).

b. Feed, Seed, Fertilizer, Pollination Agents, and Chemical Sprays

The sale of feed, seed, fertilizer, pollination agents, and chemical sprays to farmers (including those that participate in specified federal conservation and habitat protection programs or under a cooperative habitat agreement with the Washington State Department of Fish & Wildlife) are exempt from sales and use taxes if used for the commercial production of an agricultural product. Pollination agents include insects such as bees. Chemical sprays for the post-harvest treatment of fruit to prevent scald, fungus, mold, or decay are also exempt. RCW 82.04.050(8).

c. Feed for Cultivating Fish

The sale of feed for cultivating or raising fish within confined rearing areas on the person's own land or land in which the person has a present right of possession is exempt from sales and use taxes. RCW 82.08.0294 and 82.12.0294.

d. Feed Consumed by Livestock at a Public Livestock Market

Feed consumed by livestock at a public livestock market is exempt from sales and use taxes. RCW 82.08.0296 and 82.12.0296.

e. Pollen

The sale of pollen is exempt from sales and use taxes. RCW 82.08.0277 and 82.12.0273.

f. Animal Pharmaceuticals

Animal pharmaceuticals approved by the United States Department of Agriculture or by the United States Food and Drug Administration sold to farmers or veterinarians are exempt from sales and use taxes if administered to an animal raised by a farmer for sale. RCW 82.08.880 and 82.12.880.

g. Horticultural Packaging

Materials and supplies used in packing horticultural products are exempt from sales and use taxes if the income from the activities is deductible under the B&O tax. RCW 82.08.0311 and 82.12.0311.

h. Propane or Natural Gas for Chicken Coops

Sales to farmers of propane or natural gas used to heat structures that house chickens are exempt from sales and use taxes. RCW 82.08.910 and 82.12.910. (Currently, natural gas in not subject to the sales tax.)

i. Bedding Materials for Chickens

Sales to farmers of bedding materials for chickens, such as wood shavings, straw, and similar materials, are exempt from sales and use taxes. RCW 82.08.920 and 82.12.920.

3. Structures, Machinery, & Equipment

a. Auction Sales

Sales of tangible personal property that was used in a farm activity (e.g., farm machinery and implements) sold through auctioneers is exempt from sales tax if the seller is a farmer and the sale is held on a farm. RCW 82.12.0258.

b. Machinery & Implements for Use Outside the State

Sales to nonresidents of machinery and implements for use in farming, parts for machinery and implements for use in farming, and labor for the repair of machinery, implements, and parts for use in farming are exempt from sales tax if the goods are immediately transported outside the state. RCW 82.08.0268.

c. Irrigation Equipment Leases

Leases of irrigation equipment which is in whole or in part attached to the land and is an incidental part of the land lease is exempt from sales tax, provided the sales or use tax was paid on the original purchase of the equipment by the owner. RCW 82.08.0288 and 82.12.0283.

d. Food Processing Property Sale/Leaseback

Property and equipment used in the business of processing fresh fruit, vegetables or fish is exempt from sales tax if it is leased by the original owner under the terms of a sale/leaseback transaction. RCW 82.08.0295 and 82.12.0295. This would also be exempt under the manufacturing machinery and equipment exemption under RCW 82.08.02565 and 82.12.02565.

e. Farm Worker Housing

Labor, services, and materials used to construct, repair, decorate, or improve agricultural employee housing is exempt from sales and use tax. The housing must be used for 5 consecutive years or the full tax, with interest, is due. RCW 82.08.02745 and 82.12.02685.

f. Equipment & Structures to Reduce Field Burning

Sales of certain machinery and equipment to qualified farmers are exempt from sales and use tax. A qualified farmer is one who has more than fifty percent of his or her tillable acres in cereal grains and/or field and turf grass grown for seed in counties where cereal grain production exceeds 15,000 acres. Eligible machinery and equipment includes no-till drills, minimum-till drills, chisels, plows, sprayers, discs, cultivators, harrows, mowers, swathers, power rakes, balers, bale handlers, shredders, transplanters, tractors two hundred fifty horsepower and over designed to pull conservation equipment on steep hills and highly erodible lands, and combine components limited to straw choppers, chaff spreaders, and stripper headers. In addition, labor and services rendered in respect to constructing hay sheds for qualified farmers, and tangible personal property that becomes an ingredient or component of hay sheds during the course of construction, is also exempt. These exemptions expire January 1, 2011. RCW 82.08.--- and 82.12.--- (2005 c 420 ss 2 & 3).

g. Dairy Nutrient Management Equipment and Facilities

Maintenance and repair of dairy nutrient management equipment and facilities is exempt from sales and use taxes. RCW 82.08.890 and 82.12.890.

h. Anaerobic Digester

Purchase, construction, and repair of an anaerobic digester used primarily to treat dairy manure is exempt from sales and use taxes. RCW 82.08.900 and 82.12.900.

i. Cold Storage Warehouses and Grain Elevators

A tax incentive exists for wholesalers or third-party warehousers for the construction of cold storage warehouses and grain elevators and on the purchase of material-handling and racking equipment, and labor and services rendered in installing, repairing, cleaning, altering, or improving the equipment.

For cold storage warehouses, the taxpayer is entitled to a refund exemption equal to 100 percent of the state sales and use tax on material-handling and racking equipment and 100 percent of the state sales and use tax on construction costs. For grain elevators with bushel capacity between 1,000,000 and 2,000,000, the taxpayer is entitled to a refund exemption equal to 50 percent of the state sales and use tax paid. For grain elevators with bushel capacity of 2,000,000 or more, the taxpayer is entitled to a refund exemption equal to 50 percent of the state sales and use tax on material-handling and racking equipment and 100 percent of the state sales and use tax on construction costs. The taxpayer must initially pay all applicable taxes and then apply for reimbursement to the Department of Revenue. RCW 82.08.820 and 82.12.820.

j. Manufacturing Machinery & Equipment

While not applicable to farmers, there are exemptions available to agriculture-related manufacturers. New or replacement manufacturing machinery and equipment is exempt from sales and use taxes. RCW 82.08.02565 and 82.12.02565. This does not apply to short-lived tools, hand tools, or consumable supplies.

VI. Retail Sales & Use Tax Deferrals/Exemptions

A. Manufacturing Facilities in Rural Counties

The rural county deferral/exemption program targets rural counties with population densities of less than 100 per square mile or smaller than 225 square miles, community empowerment zones, and counties containing a community empowerment zone. Manufacturing, research and development, and computer service businesses may defer sales and use taxes on buildings, machinery and equipment, and installation labor. That portion of a cogeneration project that generates power for consumption within the manufacturing site qualifies if an integral part of the manufacturing operation. An expansion or renovation must increase the floor space or production capacity of an existing structure to qualify. The business is required to create at least one job per $750,000 of investment if the project is in a community empowerment zone or a county containing a community empowerment zone. The deferred taxes are forgiven if the investment project meets the program criteria for eight years after the project is complete. Because manufacturing machinery and equipment, pollution control equipment, and cogeneration equipment used in a manufacturing process is exempt from sales tax, no tax on these items need be paid. The program expires July 1, 2010. Chapter 82.60 RCW.

B. Processing & Cold Storage Warehousing of Fruits and Vegetables

Beginning July 1, 2007, fruit and vegetable processing, cold storage warehousing of fruits or vegetables, and related research and development businesses statewide may defer sales and use taxes on buildings, machinery and equipment, and installation labor. The

deferred taxes are forgiven if the investment project meets the program criteria for eight years after the project is complete. Because manufacturing machinery and equipment, pollution control equipment, and cogeneration equipment used in a manufacturing process is exempt from sales tax, no tax on these items need be paid. The program is not available if a refund is requested under the cold storage warehouse exemption. See Cold Storage Warehouses and Grain Elevators, page 9. The program expires July 1, 2012. Chapter 82.--- RCW (2005 c 513 ss 4-10).