FARM CLOSE-OUT SALES TAX EXEMPTION

EVALUATION SUMMARY

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SEPTEMBER 2018
2018-TE3

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1945
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	Could not determine
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes, but with variable impact based on local taxes

WHAT DOES THIS TAX EXPENDITURE DO?

Sales of property used for farming or ranching by Colorado agricultural producers who are abandoning operations and holding a farm close-out sale, either by auction or private sale, are not subject to state sales tax and some local sales taxes under this exemption.

WHAT DID THE EVALUATION FIND?

The exemption appears to be meeting its purpose, primarily because it eliminates the local sales taxes that would otherwise apply to farm close-out sales in many local jurisdictions, although this impact varies widely depending on local tax policies. The exemption has a limited impact on state sales tax liability for most buyers because most of the transactions at farm close-out sales are now exempt from state sales tax under other tax provisions enacted since the Farm Close-Out Sales Tax Exemption was created.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Farm Close-Out Sales Tax Exemption. Based on statutory language, we inferred that the purpose was to encourage the purchase and transfer of used agricultural equipment and supplies from agricultural producers who are abandoning operations to new and ongoing agricultural producers by reducing the cost to buyers.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may wish to review this expenditure's exemption of on-road motor vehicles sold at farm close-out sales from sales tax, because this appears inconsistent with other tax expenditures that are intended to reduce the sales tax liability of farmers and ranchers.

FARM CLOSE-OUT SALES TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Farm Close-Out Sales Tax Exemption [Section 39-26-716(4)(a), C.R.S.] was enacted in 1945 and exempts from sales tax all purchases made at "farm close-out sales," which are sales of an outgoing farmer's or rancher's tangible personal property, including equipment, vehicles, and other physical property, that is used to carry out agricultural operations [Section 39-26-102(4), C.R.S.]. The exemption applies to state sales and use tax and local sales and use taxes for local governments, such as cities and counties, for which the state collects sales tax. Home-rule jurisdictions established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes have the authority to enact their own tax policies and are not required to provide the exemption. To qualify for the exemption, the farmer or rancher must be attempting to dispose of all property used in their agricultural operation, which could include tractors, combines, grain handling equipment, sprayers, motor vehicles, or livestock, and abandoning the operation. Farmers and ranchers may retain their real and tangible nonagricultural property, such as their home and personal property, and still have the sale qualify for the exemption. Farm close-out sales can be made through auctions, estate sales or, beginning in 1964, private sales between farmers or ranchers and buyers.

The Farm Close-Out Sales Tax Exemption is typically applied at the point of sale and provides an exemption from the general requirement that sellers of tangible personal property collect and remit state sales tax from buyers. In most cases, sellers holding a farm close-out sale, which are typically the farmers or ranchers who own the property or auction firms that they hire to conduct the sale, are required to obtain a sales tax license and report the value of exempt sales to the Department of

Revenue using its Retail Sales Tax Return (Form DR 0100). The amount sellers report on this form is aggregated with several other sales tax exemptions and sellers are not required to report how much is attributable to this specific exemption. Outgoing farmers and ranchers privately disposing of agricultural items worth $1,000 or less in a given year are not required to obtain a sales tax license, but must still report state sales and use tax on Department of Revenue tax form DR 0100A. This form, which is used to report and remit state sales and use tax from occasional sales of $1,000 or less each year, also does not require the seller to specifically report the amount applied to the Farm Close-Out Sales Tax Exemption.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. Based on the statutory language, we infer that the intended beneficiaries of this exemption are farmers and ranchers who are abandoning their agricultural operations, and purchasers—primarily other farmers and ranchers—of tangible personal property from farm close-out sales. We could not identify statistics regarding the number and size of farm close-out sales that occur in the State. However, agricultural industry representatives and respondents to our survey of farmers and ranchers indicated that farm close-out sales are common within the agricultural industry, and the auction firms we spoke with reported that their practice is to apply the Farm Close-Out Sales Tax Exemption when they hold farm close-out auctions.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Based on the statutory language and its historical context, we inferred that the purpose was to encourage the sale and transfer of used agricultural equipment and supplies from farms and ranches that were closing to those with new and ongoing agricultural operations by reducing the cost to buyers purchasing such equipment and supplies. At the time of the exemption's enactment in 1945, which was during the final months of World War II, the supply of new farm machinery could not keep up with the large demand for U.S. agricultural products from domestic and international buyers. Farm close-out auctions were likely an affordable means for farmers and ranchers to procure such equipment from those leaving the sector. Therefore, the General Assembly may have intended the expenditure to encourage these sales by reducing the after-tax cost of the equipment.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Farm Close-Out Sales Tax Exemption is meeting its purpose, although its impact is primarily limited to taxing jurisdictions that apply a sales tax on farm equipment.

Statute does not provide quantifiable performance measures for this expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its inferred purpose:

PERFORMANCE MEASURE: *Does the Farm Close-Out Sales Tax Exemption reduce the cost of purchasing agricultural equipment and supplies through farm close-out sales?*

RESULT: The Farm Close-Out Sales Tax Exemption likely provides a cost-savings to some farmers and ranchers who purchase agricultural equipment and supplies at farm close-out sales. However, most of the potential cost savings are due to a reduction in local, as opposed to state, sales and use taxes and the cost savings vary considerably based on the interplay between the applicable state and local tax provisions.

Most of the potential cost savings from the Farm Close-Out Sales Tax Exemption do not come from a reduction in state sales taxes because most purchases of equipment and supplies at farm close-out sales that are to be used for agricultural purposes are also exempt from state sales tax under other state tax expenditure provisions. Specifically, Sections 39-26-102(19) and 716, C.R.S., provide broader exemptions from sales and use tax for purchases of most farm equipment and supplies, regardless of whether they occur at a farm close-out sale, at retail, or between individuals outside of a farm close-out sale. With the exception of sales tax exemptions for the sale of livestock, feed, seed, and orchard trees that were enacted along with the Farm Close-Out Sales Tax Exemption, these broader exemptions did not exist in 1945, when the Farm Close-Out Sales Tax Exemption was created. However, with the establishment of these broader sales tax exemptions for agricultural purchases, the impact of the Farm Close-Out Sales Tax Exemption, as it relates to the state sales tax paid by farmers and ranchers, has been significantly reduced. Instead, the unduplicated state sales tax cost savings provided by the Farm Close-Out Sales Tax Exemption is mainly limited to purchasers who do not intend to use the items for an agricultural purpose under Section 39-26-716, C.R.S., and purchasers of on-road motor vehicles, because such purchases do not fall under the other agricultural exemptions and would otherwise be taxed.

Despite its limited impact on farm close-out buyers' state sales tax costs, the Farm Close-Out Sales Tax Exemption may provide a significant cost savings in some local taxing jurisdictions. This is because under Section 29-2-105(1)(d), C.R.S., although the Farm Close-Out Sales Tax Exemption applies to the calculation of local sales taxes in all local jurisdictions for which the state collects sales taxes, the broader exemption for sales of farm equipment under Section 39-26-716, C.R.S., only applies to the local sales tax in these jurisdictions if they have specifically ratified a local provision to exempt farm equipment. Therefore, in state-collected jurisdictions that do not exempt farm equipment from sales and use tax, the Farm Close-Out Sales Tax Exemption continues to provide a significant cost savings on purchases of such equipment.

Based on our review of tax rate information published by the Department of Revenue, only 19 of the State's 64 counties have enacted the farm equipment sales tax exemption. An additional 10 counties do not have any sales tax and two more are home-rule counties that are not administered by the State, leaving 33 counties where the Farm Close-Out Sales Tax Exemption provides an unduplicated cost savings on purchases of farm equipment. Similarly, 8 municipalities and 19 special districts that have their sales taxes collected by the State have farm equipment exemptions in place, leaving 143 municipalities and 12 special districts where the Farm Close-Out Sales Tax Exemption would provide an additional cost savings. These jurisdictions are distributed across the state and include many locations with significant agricultural economies. Based on our review of local sales tax rates, the population-weighted, average combined local tax rate in Colorado is 1.8 percent, excluding self-collected home-rule jurisdictions. Therefore, for some large purchases that would otherwise be taxed at the local level, the Farm Close-Out Sales Tax Exemption can provide a significant benefit to buyers. This benefit can vary widely based on the local tax rates, which can be as high as 7.5 percent or as low as 0.25 percent for the relevant locations. Overall, these tax benefits could provide a strong enough incentive to encourage some farmers and ranchers to participate in farm close-out sales, especially if they plan to purchase more expensive equipment. For example, a farmer purchasing a $50,000 used tractor at a farm close-out sale would save $900, based on the 1.8 percent average population-weighted local tax rate for state-collected local governments.

It is also important to note that neither the Farm Close-Out Sales Tax Exemption, nor any other exemption that may apply to a purchase at a farm close-out sale, necessarily applies to the local sales tax in home-rule taxing jurisdictions established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes. These 71 jurisdictions, which include all of the State's most-populated cities, set their own sales tax ordinances independent of state control. While some exempt purchases at farm close-out sales from sales tax, such provisions operate outside of the State's authority.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

The Farm Close-Out Sales Tax Exemption has a relatively small impact on state revenue because most of the transactions that occur through farm close-out sales would likely be exempt from state sales tax because of other sales tax exemptions. However, the exemption likely results in some lost state revenue, in particular for motor vehicles and items that are sold to buyers who intend to use the items for a non-agricultural purpose. In addition, the exemption probably reduces the revenue of state-collected local taxing jurisdictions that do not otherwise exempt sales of farm equipment from sales taxes. This local impact is likely greatest in jurisdictions where agricultural operations make up a substantial part of the local economy.

Furthermore, the exemption likely provides a financial benefit to buyers, in particular those making purchases in local taxing jurisdictions that would otherwise levy a sales tax on the purchase, those who purchase motor vehicles, and those who do not intend to use the items purchased for an agricultural purpose. Overall, this financial benefit may increase interest and participation in farm close-out sales from these buyers, which would help sellers conducting farm close-out sales to find buyers and ease the process of winding down their agricultural operations. As discussed further below, we could not identify a reliable data source to quantify the sales volume and number of farm close-out sales that occur in Colorado, the types of items sold, or the buyers' intended use (i.e., agricultural vs. non-agricultural). Therefore, we were not able to quantify the potential economic costs and benefits.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Farm Close-Out Sales Tax Exemption would increase taxes for some buyers at farm close-out sales. It appears that buyers in certain local taxing jurisdictions that do not exempt farm equipment sales from tax, non-agricultural buyers, and motor vehicle buyers would pay most of this additional tax, since the purchases of most agricultural buyers would otherwise already be exempt under other sales tax exemptions. Eliminating the exemption might also have a modest financial impact on farmers and ranchers who are closing out their operations, since the additional tax on buyers could reduce the number of participants at auctions or decrease the price buyers at private sales are willing to pay.

Eliminating the exemption would also change the administrative requirements for sellers. For example, auctioneers facilitating close-out sales would no longer need to verify and collect written declarations from outgoing farmers and ranchers that the items they sell were previously used as part of an agricultural operation and are therefore, exempt under the Farm Close-Out Sales Tax Exemption. On the other hand, sellers, including both auctioneers and farmers and ranchers making private sales, would need to verify that buyers intend to use the items purchased for an agricultural purpose in order to apply other available state sales tax exemptions. Further, some farmers and ranchers may face the additional requirement to obtain sales tax licenses if some items they sell at the farm close-out sale become taxable (e.g., equipment that will not be used for agriculture). However, it is unclear how much of an additional burden this would create since some farmers and ranchers conducting farm close-out sales already fall under this requirement if they sell some items as part of the sale that do not qualify for the exemption, such as personal property that was not used for their agricultural operation.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 other states and the District of Columbia that impose a sales tax, we identified five states that have a tax expenditure similar to the Farm Close-Out Sales Tax Exemption. These other states' expenditures are listed in EXHIBIT 1.1, along with comparisons to Colorado's exemption.

EXHIBIT 1.1. COMPARISON OF COLORADO'S FARM CLOSE-OUT SALES TAX EXEMPTION AND OTHER STATES' SIMILAR EXEMPTIONS

State	Type of Sales Tax Expenditure	Private Sales Covered?	Type of Eligible Items	Only Applies to "Close-Outs"[1]?	Must Take Place on Farm/Ranch?
Colorado	Exemption	Yes	Property used in agriculture	Yes	No
Minnesota	Exemption	No	Property used in agriculture Nonbusiness property (e.g., household goods)	No	No
Missouri	Exemption	Yes	All property except inventory	Yes	No
North Dakota	Exemption	No	All property	No	No
Washington	Exemption	No	Property (including household goods) used in agriculture Does not apply to property used in production of marijuana	No	Yes
Wisconsin	Exemption	No	Property used in agriculture, and household goods Does not apply to highway vehicles, boats, pets, and recreational animals not used in farming (e.g., racing, riding, or show animals)	No	No, but must take place "at a location where the auctioneer holds 5 or fewer auctions" per year

SOURCE: Source: Bloomberg BNA Tax and Accounting Center.
[1] "Close-Outs" refers to situations where the owner of the agricultural operation is planning to cease operations and is attempting to sell off their assets, with the exception of real estate and personal assets.

One reason that most other states do not have a farm close-out sales tax exemption is that other, broader exemptions for occasional or isolated sales likely cover the same transactions in those states, making such an exemption unnecessary. Specifically, 42 states and the District of Columbia exempt occasional sales and purchases from sales tax, which typically includes nonrecurring and infrequent sales of tangible personal property by an individual who is not in the business of selling that type of property. Many of the items sold through a farm close-out sale would likely fall under this type of exemption. However, Colorado does not have a similar exemption for occasional sales, though, as mentioned above, it does not require a sales tax license for sellers that make occasional sales of $1,000 or less per year.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

There are several other state tax expenditures that potentially exempt property sold through a farm close-out sale from sales tax. Unlike the Farm Close-Out Sales Tax Exemption, these expenditures require the purchaser to be engaged in an agricultural business and to use the property purchased for an agricultural purpose. Together, these expenditures exempt much of the equipment and supplies purchased by farmers and ranchers and likely overlap with most of the items sold at farm close-out sales.

Specifically, the following sales tax exemptions could apply to property sold at a farm close-out sale:

- **LIVESTOCK EXEMPTION** [Section 39-26-716(4)(a), C.R.S.]. Established in 1943, this exempts most sales of livestock from state sales tax. The exemption includes most animals raised for commercial purposes, other than those being raised to be sold as pets.

- **FEED FOR LIVESTOCK, SEEDS, AND ORCHARD TREES EXEMPTION** [Section 39-26-716(4)(b), C.R.S.]. Established in 1945, along with the Farm Close-Out Sales Tax Exemption, this exempts sales of feed, seeds, and orchard trees used for agricultural purposes.

- **STRAW FOR LIVESTOCK AND POULTRY BEDDING EXEMPTION** [Section 39-26-716(4)(c), C.R.S.]. Established in 1961, this exempts agricultural purchases of straw used for animal bedding.

- **FARM AND DAIRY EQUIPMENT AND PARTS EXEMPTION** [Sections 39-26-716(2)(b) and (3)(b), C.R.S.]. Established in 1999 and expanded in 2001, this exempts most purchases of equipment used for agricultural purposes from sales tax. However, it does not apply to on-road motor vehicles which must be registered in the state, regardless of whether they are used for an agricultural purpose.

- **WHOLESALE ADJUVANTS, SEMEN FOR AGRICULTURAL PURPOSES, AGRICULTURAL COMPOUNDS, AND PESTICIDES EXEMPTION** [Section 39-26-102(19)(c) and (d), C.R.S.]. Originally, established in 1999 and expanded in 2012, this includes the sale of adjuvants, semen, agricultural compounds, and pesticides within the definition of wholesale sales, which are exempt from sales tax.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department of Revenue does not track farm close-out sales revenue, the amount of Farm Close-Out Sales Tax Exemption claimed, or the taxpayers who claim it, and we could not identify any other reliable source to obtain this information. Specifically, the Department of Revenue's Retail Sales Tax Return (Form DR 0100) does not contain a specific line for the Farm Close-Out Sales Tax Exemption and taxpayers must lump this expenditure's total into a line that includes all exemptions not specifically listed on the form. Since this line can encompass several different exemptions, the Department of Revenue does not capture this data point in GenTax, its tax processing and information system. If the General Assembly wants to know how many taxpayers claim the Farm Close-Out Sales Tax Exemption and how much they claim, it could require the Department of Revenue to add a specific line to the DR 0100 where taxpayers would be required to report this information and direct the Department of Revenue to capture the data in GenTax. However, this change would require resources for the Department of Revenue to update the form, provide new instructions, and make programming changes in GenTax to capture the information. (See the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and the potential costs of addressing these limitations.) Additionally, the change would increase the administrative burden on sellers who would be required to separately track and report exempt farm close-out sales.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

Because the Farm Close-Out Sales Tax Exemption's exemption of on-road motor vehicles from state and local sales tax is inconsistent with the State's treatment of most other motor vehicle purchases, the General Assembly may wish to review this aspect of the expenditure. Although the language of the exemption does not specifically list motor vehicles as an item exempted from sales tax, it defines the items that can be exempted as "all tangible personal property of a farmer or rancher previously used by him in carrying on his farming or ranching operations." Therefore, if an on-road motor vehicle was used for farming and ranching operations, its sale falls within the exemption.

However, in 1999 when the General Assembly enacted the Farm Equipment Sales Exemption [Section 39-26-716(2)(b), C.R.S.], which is also intended to reduce the sales tax liabilities of farmers and ranchers, it specifically included on-road motor vehicles (i.e., those subject to the State's vehicle registration requirements) "regardless of the purpose for which such vehicles are used" in a list of items that do not qualify as "Farm Equipment" for the purposes of qualifying for the exemption [Section 39-26-716(1)(d), C.R.S.]. Because it is not clear whether the General Assembly intended to include on-road motor vehicles within the items exempted from sales tax when the Farm Close-Out Sales Tax Exemption was enacted in 1945, it may wish to review and, if necessary, amend the language of the exemption to reflect its tax policy preferences. Although we could not quantify the potential revenue impact of this aspect of the exemption during this review, the Department of Revenue reported that in Calendar Year 2018 it plans to begin tracking data related to taxpayers who purchased used vehicles at farm close-out sales who claimed the exemption, so in the future there may be better data regarding the potential revenue impact to the State.