



FARM EQUIPMENT AND PARTS EXEMPTION

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE5

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|------------------------|---------------|---------------------|---------------------|
| TAX TYPE | Sales and use | REVENUE IMPACT | \$16.3 million |
| YEAR ENACTED | 1999 | NUMBER OF TAXPAYERS | Could not determine |
| REPEAL/EXPIRATION DATE | None | | |

KEY CONCLUSION: The exemption is widely used by agricultural producers to avoid sales and use tax on their purchases of farm and dairy equipment.

WHAT DOES THE TAX EXPENDITURE DO?

The Farm Equipment and Parts Exemption (Farm Equipment Exemption) [Section 39-26-716 (1)(c), (4)(e), and (4)(f)(I), C.R.S.] exempts sales of farm and dairy equipment and parts of any amount, and leases of equipment and parts worth \$1000 or more from sales and use tax. Under Section 39-26-716 (1)(c) and (d), C.R.S., eligible farm and dairy equipment includes: tractors, implements of husbandry, irrigation equipment of at least \$1000, bailing wire, any item used at a farm dairy in connection with the production of raw milk, and parts used for the repair and maintenance of eligible equipment.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Farm Equipment Exemption; therefore, we could not definitively determine the General Assembly's original intent. However, based on the operation of the exemption and similar exemptions in Colorado, legislative testimony, and conversations with stakeholders, we

considered a potential purpose: to avoid applying sales and use tax to equipment necessary to produce agricultural products that may be subject to sales tax when sold to consumers.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider establishing a statutory purpose and performance measures for the exemption.



FARM EQUIPMENT AND PARTS EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Farm Equipment and Parts Exemption (Farm Equipment Exemption) [Section 39-26-716(1)(c), (4)(e), and (4)(f)(I), C.R.S.] exempts from sales and use tax: *sales* of eligible farm and dairy equipment and parts of any value, and *leases* of eligible farm and dairy equipment and parts with a fair market value of at least \$1,000. Under Section 39-26-716(1)(c) and (d), C.R.S., eligible farm and dairy equipment includes, but is not limited to:

- Tractors
- Implements of husbandry
- Irrigation equipment with a purchase price of at least \$1,000
- Bailing wire
- Any item used at a farm dairy in connection with the production of raw milk
- Parts used for the repair and maintenance of eligible equipment

To qualify, the equipment must be used directly and primarily for a farm, ranch, or livestock production operation. The exemption does not include items used in a manner that is only incidental to an agricultural operation, or commercial dairy equipment used to pasteurize or separate milk, or on-road motor vehicles, regardless of whether they are used in an otherwise eligible agricultural operation.

Additionally, under Section 29-2-105(1)(d)(I), C.R.S., local governments that have their sales taxes collected by the State may choose whether to adopt the exemption. Currently, 10 state-collected cities and 19 state-collected counties have adopted the exemption. Home rule cities and counties, established under Article XX, Section 6 of the Colorado Constitution, that collect their own sales taxes may set

their own tax policy independently from the State and are not required to have an exemption for sales of farm equipment. We found that eight of the 15 most populous home rule cities in the state have adopted a sales tax exemption for farm equipment.

The exemption was created in 1999 by House Bill 99-1002 and was expanded in 2000 by House Bill 00-1162, which added parts used to repair and maintain equipment to the list of eligible items, and in 2001 by House Bill 01-1256, which added dairy equipment and parts.

To qualify for the exemption, purchasers must present an Affidavit for Colorado Sales Tax Exemption for Farm Equipment (Form DR 0511) to vendors stating that they meet the qualifications for the exemption. Vendors then apply the exemption and report exempt sales using the Colorado Retail Sales Tax Return (Form DR 0100).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the intended beneficiaries of the Farm Equipment Exemption. Based on the operation of the exemption, we considered the direct beneficiaries to be agricultural producers because they are able to avoid paying sales and use tax on their purchases of equipment and parts used for their agricultural operations. According to data from the U.S. Department of Agriculture (USDA), there were about 39,000 farms in the state as of Calendar Year 2017 that could potentially benefit from the exemption. Farm equipment vendors may also benefit to the extent that agricultural producers purchase additional equipment due to the exemption since it decreases the equipment's after-tax cost.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Farm Equipment Exemption; therefore, we could not definitively determine the General Assembly's original intent. However, based on the operation of the exemption and other similar exemptions in Colorado, legislative

testimony, and conversations with stakeholders, we considered a potential purpose: to avoid applying sales and use tax to equipment necessary to produce agricultural products that may be subject to sales tax when sold to consumers. This exemption is consistent with other sales and use tax exemptions in Colorado and other states for machinery, equipment, and supplies used to produce consumer goods.

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

We could not definitively determine whether the Farm Equipment Exemption is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that it is meeting the potential purpose we considered in order to conduct our evaluation because eligible beneficiaries are aware of and using it.

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

PERFORMANCE MEASURE: *To what extent is this exemption being used by agricultural producers?*

RESULT: We determined that the exemption is being widely used by agricultural producers in the state. Based on Department of Revenue (Department) data, vendors applied the exemption to about \$526 million in agricultural equipment sales in Calendar Year 2019, with about 416 vendors reporting the exemption on their sales tax returns. According to stakeholders, agricultural producers know about the exemption and commonly claim it when making eligible purchases.

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

According to the Department's *2020 Tax Profile & Expenditure Report*, the exemption resulted in about \$16.3 million in forgone state revenue and a corresponding tax savings for beneficiaries in Calendar Year 2019, up from about \$14 million in 2017.

The exemption also reduces local government sales tax revenue and provides a corresponding benefit to agricultural producers in the 10 cities and 19 counties that have adopted the exemption. Although we lacked data necessary to quantify the revenue impact to these local governments, the sales tax rates in these cities and counties range between 0.25 percent and 6.50 percent, which is equivalent to the additional after-tax cost savings agricultural producers would realize due to the local exemption. Home rule cities and counties that collect their own sales taxes are not required to apply the exemption and only eight of the 15 most populous home rules cities and counties have decided to apply it. Therefore, purchases of farm equipment are still subject to local sales tax in most areas of the state.

Stakeholders reported that the reduced after-tax cost resulting from the exemption provides an important economic benefit because many agricultural producers operate on small margins and would have difficulty absorbing the additional sales tax cost for purchases of equipment. Additionally, for most agricultural producers, it would be difficult to pass the cost of sales tax on equipment to consumers in the form of higher prices since most producers must sell their products at established market prices for agricultural commodities. In particular, stakeholders reported that the exemption is impactful for purchases of more expensive equipment, such as tractors and combines. According to a stakeholder, who is a tractor dealer, the cost of a 75 horsepower tractor is between \$49,000 and \$55,000. For a purchase in this price range, the exemption would provide a savings between \$1,420 and \$1,600. In comparison, according to the USDA, the average farming operation earned a profit of \$29,700 in 2017.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Elimination of the tax expenditure would result in agricultural producers having to pay the State's 2.9 percent sales tax on purchases and leases of farm and dairy equipment and parts. Additionally, the purchases would be subject to additional local sales taxes in the 10 cities and 19 counties that have their sales taxes collected by the State that have adopted the exemption if it were eliminated. According to stakeholders, it would be difficult for agricultural producers to absorb this additional cost and some would likely reduce their equipment purchases, potentially by waiting longer to replace or repair older equipment. Stakeholders also noted that some would go to other states that have a sales tax exemption for farm equipment to purchase equipment and parts, and reported that this happened when there was a temporary hiatus of the exemption in 2010. Although the use tax rate still applies to out-of-state equipment purchases, use tax can be difficult for the State to enforce since it generally must be self-reported by purchasers. Therefore, to the extent that agricultural producers would be discouraged from making purchases in the state, eliminating the exemption could also reduce revenue for farm equipment vendors.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 45 states that levy a sales and use tax, 38, including all the states bordering Colorado, have an exemption for farm equipment. Though most states' exemptions are similar to Colorado's, we identified some states that place additional limits on the exemption. For example, Alabama and California only provide partial exemptions for farm and dairy equipment and Louisiana limits the exemption to the first \$50,000 spent on farm equipment annually.

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

We identified the following tax expenditures with a similar purpose of exempting equipment and inputs used in the production of goods that are subject to sales tax when sold to final consumers:

MACHINERY USED IN MANUFACTURING EXEMPTION [Section 39-26-709, C.R.S.] — Exempts purchases greater than \$500 of machinery used predominately in manufacturing tangible personal property from sales and use tax.

AGRICULTURAL INPUTS EXEMPTIONS [SECTION 39-26-716, C.R.S.] — Exempts sales of livestock, seeds, livestock bedding, and other agricultural materials from sales and use tax.

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

There were no data constraints that impacted our ability to evaluate the tax expenditure.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE FARM EQUIPMENT EXEMPTION. As discussed, statute and the enacting legislation for the exemption do not state the exemption's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose: to avoid applying sales and use tax to equipment necessary to produce agricultural products that may be subject to sales tax when sold to consumers. We identified this purpose based on our review of the statutory language, legislative testimony, and conversations with stakeholders. We also developed a performance measure to assess the extent to which the exemption is meeting its

potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).