



STATE BOARD OF EQUALIZATION
PROPERTY TAXES DEPARTMENT
450 N STREET, MIC: 64, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0064
TELEPHONE (916) 445-4982
FAX (916) 323-8765
www.boe.ca.gov

JOHAN KLEHS
First District, Hayward

DEAN ANDAL
Second District, Stockton

CLAUDE PARRISH
Third District, Torrance

JOHN CHIANG
Fourth District, Los Angeles

KATHLEEN CONNELL
State Controller, Sacramento

JAMES E. SPEED
Executive Director

May 3, 2002

No. 2002/029

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

PARTIAL SALES AND USE TAX EXEMPTION FOR
FARM EQUIPMENT AND MACHINERY

Assembly Bill 426, Chapter 156 of the Statutes of 2001, effective September 1, 2001, added section 6356.5 to the Revenue and Taxation Code¹ to exempt qualified sales and purchases (including leases) of farm equipment and machinery from the state general fund portion of the sales tax, when such property is used primarily in producing and harvesting agricultural products. In addition, Sales and Use Tax Regulation 1533.1, *Farm Equipment and Machinery*, has been proposed to interpret, implement, and make specific section 6356.5. A public hearing regarding this regulation was held on March 27, 2002 and the Board approved the regulation at that time. Although the rule was approved by the Board, we refer to it as a "proposed" regulation because it will not become operative until it is approved by the Office of Administrative Law and filed with the Secretary of State. This letter discusses the effect of this new partial sales tax exemption and the proposed regulation on the valuation of such property for property tax purposes.

The current state general fund portion of the sales and use tax rate is 5 percent. (A list of the state's general fund portion of the sales and use tax rate for previous years is enclosed as Attachment 2.) The partial exemption does not apply to any local, city, county, or district taxes. These portions of the sales tax will continue to be applied to sales and purchases of *farm equipment and machinery* and, therefore, part of the economic cost of the property for property tax purposes. With regard to the exemption allowed on equipment, the property must be purchased for use by a *qualified person* to be used *primarily in producing and harvesting agricultural products*. *Primarily* means used 50 percent or more of the time for these purposes.

Definitions

In general, *farm equipment and machinery* means implements of husbandry, which is defined in section 411:

¹ All references herein are to the Revenue and Taxation Code unless otherwise indicated.

. . . "*implements of husbandry*" includes, but is not limited to, any tool, machine, equipment, appliance, device or apparatus used in the conduct of agricultural operations, except where such implements are intended for sale in the ordinary course of business.

"*Implement of husbandry*" also includes those implements of husbandry as defined in the Vehicle Code. (Italics added.)

Proposed regulation 1533.1 provides a detailed listing of items included as implements of husbandry (i.e., farm equipment and machinery). The proposed regulation includes such items as "combines, harrows, tractor implements, agricultural heating and cooling equipment, fuel storage equipment, wind machines, handling and packing equipment and conveyors," etc. Additionally, the proposed regulation states that "[f]arm equipment and machinery may be attached to realty." In other words, this partial exemption also applies to fixtures.

The partial exemption also applies to repair and replacement parts for the farm equipment and machinery. Parts of farm equipment and machinery include component parts and contrivances such as belts, shafts, pipes, hoses and moving parts, that are used to replace parts of qualified equipment and machinery as defined in section 411. Parts of farm equipment and machinery do not include items that are consumed during the regular use of the equipment. These items are considered supplies and the amount on hand on the lien date is assessable for property tax purposes with the sales tax component included in the economic cost.

Qualified person is defined in section 6356.5 to mean "any person engaged in a line of business described in Codes 0111 to 0291, inclusive, of the Standard Industrial Classification Manual (SIC Manual) published by the United States Office of Management and Budget, 1987." These codes are included in Major Group 01 and Major Group 02, which are listed in Attachment 1. (Major Group 01 provides a listing of establishments involved in the agricultural production of crops. Major Group 02 provides a listing of establishments involved in the agricultural production of livestock and animal specialties.) A qualified person also includes a person that assists a qualified person.

Proposed regulation 1533.1 defines *person that assists a qualified person* as "a person employed by a qualified person, or engaged on a contract or fee basis to perform activities described in Major Group 07" of the SIC Manual. Major Group 07 provides a listing of establishments involved in agricultural services.² The proposed regulation further provides that a "person that assists a qualified person must provide physical aid or assistance in the actual producing and harvesting of agricultural products owned by the qualified person and not merely provide aid in administrative, managerial, or marketing activities."

In general, *producing and harvesting agricultural products* is defined in proposed regulation 1533.1 to mean "those activities described in Major Groups 01, 02 and 07 of the SIC Manual." Further, "[p]roducing and harvesting agricultural products involves the cultivation of land or the

² See Attachment 1 for activities described in Major Group 07.

growing, raising, or gathering of the commodities described in Codes 0111 to 0291 of the SIC Manual and integral activities thereto described in Code 0711 to 0783 of the SIC Manual."

Partial Exemption Certificates

The purchaser of farm equipment and machinery must complete a certificate for partial exemption, as described in Sales and Use Tax Regulation 1667, in order for the retailer to claim the partial exemption. Therefore, if the purchaser qualifies for the exemption and completes a partial exemption certificate, the amount paid for the qualifying property would not include the general fund portion of the sales (or use) tax.

Valuation of Property

As annual property statements are signed under penalty of perjury, it is assumed that the assessee includes (and excludes) all appropriate components of the economic cost of their property. Since the effective date of section 6356.5 is September 1, 2001, costs reported as 2001 acquisitions may include equipment purchased prior to September 1, with no partial sales tax exemption, and purchases after September 1. Consequently, the reported cost of such property purchased after August 31, 2001 should only include a sales tax component for any local, city, county, or district tax depending on whether the purchaser applied for the partial exemption.

Annually, personal property must be taxed in proportion to its value as defined in section 110:

... the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.

The new sales tax statute, section 6356.5, applies to both new and used property. A typical qualified purchaser of used farm equipment and machinery would be required to pay only local, city, county, or district taxes. The general rule in determining market value is that where price is the basis of value, sales/use tax, freight, and installation cost are elements of that value.³ There are exceptions to the general rule. As a result of section 6356.5, a new exception to the general rule includes qualified sales and purchases (including lease payments) of farm equipment and machinery.

For purposes of assessment, if the cost approach is used to value qualified property, the replacement or reproduction cost should not include the state general fund portion of the sales/use tax. Where reported costs are used to value qualified farm equipment and machinery and this cost includes sales tax, an adjustment should be made to remove the component of cost attributable to the state general fund portion of the sales tax. One method to make an adjustment includes removing the state general fund portion of the sales tax for each year of acquisition from the reported costs on the annual property statement. Another method may include an adjustment after the application of the index and percent good factors to the total assessed value of the

³ *Xerox Corp. v. Orange County* (1977) 66 Cal. App.3d 746.

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property. Where price guides or local sales data are used to value qualified farm equipment and machinery, only the local, city, county, or district tax should be added to the price indicated by the guides or sales data.

If you have any questions, please contact Mr. Lloyd Allred at (916) 324-7361 in our Technical Services Unit.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property Taxes Department

DJG:lf

Enclosures

ATTACHMENT 1

MAJOR GROUPS 01, 02, AND 07 (SIC MANUAL)

The following pages include tables listing the main Industry groups from the Standard Industrial Classification Manual (SIC Manual) published by the United States Office of Management and Budget, 1987 Edition. These classification codes are used in section 6356.5 and proposed Sales and Use Tax Regulation 1533.1, *Farm Equipment and Machinery*, to aid in the definitions of *qualified person*, *person that assists a qualified person*, and *producing and harvesting agricultural products*.

Major Group 01 as a whole includes:

...establishments (e.g., farms, orchards, greenhouses, nurseries) primarily engaged in the production of crops, plants, vines, and trees (excluding forestry operations). This major group also includes establishments primarily engaged in the operation of sod farms, and cranberry bogs; in the production of mushrooms, bulbs, flower seeds, and vegetable seeds; and in the growing of hydroponic crops. Seeds of field crops are classified in the same industry as crops grown for other purposes.

Major Group 02 as a whole includes:

...establishments (e.g., farms, ranches, dairies, feedlots, egg production facilities, broiler facilities, poultry hatcheries, apiaries) primarily engaged in the keeping, grazing, or feeding of livestock for the sale of livestock or livestock products (including serums), for livestock increase, or for value increase. Livestock, as used here, includes cattle, hogs, sheep, goats, and poultry of all kinds; also included in this major group are animal specialties, such as horses, rabbits, bees, pets, fish in captivity, and fur-bearing animals in captivity.

Major Group 07 as a whole includes:

...establishments primarily engaged in performing soil preparation services, crop services, veterinary services, other animal services, farm labor and management services, and landscape and horticultural services, for others on a contract or fee basis. However, feedlots and poultry hatcheries operated on a contract or fee basis are included in Major Group 02.

ATTACHMENT 1

MAJOR GROUP 01		AGRICULTURAL PRODUCTION-- CROPS
Industry Group Number	Industry No.	Description
011		Cash Grains
	0111	Wheat
	0112	Rice
	0115	Corn
	0116	Soybeans
	0119	Cash Grains, Not Elsewhere Classified
013		Field Crops, Except Cash Grains
	0131	Cotton
	0132	Tobacco
	0133	Sugarcane and Sugar Beets
	0134	Irish Potatoes
	0139	Field Crops, Except Cash Grains, Not Elsewhere Classified
016		Vegetables and Melons
	0161	Vegetables and Melons
017		Fruits and Tree Nuts
	0171	Berry Crops
	0172	Grapes
	0173	Tree Nuts
	0174	Citrus Fruits
	0175	Deciduous Tree Fruits
	0179	Fruits and Tree Nuts, Not Elsewhere Classified
018		Horticultural Specialties
	0181	Ornamental Floriculture and Nursery Products
	0182	Food Crops Grown Under Cover
019		General Farms, Primarily Crop
	0191	General Farms, Primarily Crop

(This listing in its entirety, with a further description of the industries, can be found on pages 23 through 26 of the SIC Manual.)

ATTACHMENT 1

MAJOR GROUP 02		AGRICULTURAL PRODUCTION-- LIVESTOCK AND ANIMAL SPECIALTIES
Industry Group Number	Industry No.	Description
021		Livestock, Except Dairy and Poultry
	0211	Beef Cattle Feedlots
	0212	Beef Cattle, Except Feedlots
	0213	Hogs
	0214	Sheep and Goats
	0219	General Livestock, Except Dairy and Poultry
024		Dairy Farms
	0241	Dairy Farms
025		Poultry and Eggs
	0251	Broiler, Fryer, and Roaster Chickens
	0252	Chicken Eggs
	0253	Turkeys and Turkey Eggs
	0254	Poultry Hatcheries
	0259	Poultry and Eggs, Not Elsewhere Classified
027		Animal Specialties
	0271	Fur-Bearing Animals and Rabbits
	0272	Horses and Other Equines
	0273	Animal Aquaculture
	0279	Animal Specialties, Not Elsewhere Classified
029		General Farms, Primarily Livestock and Animal Specialties
	0291	General Farms, Primarily Livestock and Animal Specialties

(This listing in its entirety, with further a description of the industries, can be found on pages 27 through 30 of the SIC Manual.)

ATTACHMENT 1

MAJOR GROUP 07		AGRICULTURAL SERVICES
Industry Group Number	Industry No.	Description
071		Soil Preparation Services
	0711	Soil Preparation Services
072		Crop Services
	0721	Crop Planting, Cultivating, and Protecting
	0722	Crop Harvesting, Primarily by Machine
	0723	Crop Preparation Services for Market, Except Cotton Ginning
	0724	Cotton Ginning
074		Veterinary Services
	0741	Veterinary Services for Livestock
	0742	Veterinary Services for Animal Specialties
075		Animal Services, Except Veterinary
	0751	Livestock Services, Except Veterinary
	0752	Animal Specialty Services, Except Veterinary
076		Farm Labor and Management Services
	0761	Farm Labor Contractors and Crew Leaders
	0762	Farm Management Services
078		Landscape and Horticultural Services
	0781	Landscape Counseling and Planning
	0782	Lawn and Garden Services
	0783	Ornamental Shrub and Tree Services

(This listing in its entirety, with a further description of the industries, can be found on pages 31 through 34 of the SIC Manual.)

ATTACHMENT 1

MAJOR GROUP 20		FOOD AND KINDRED PRODUCTS
Industry Group Number	Industry No.	Description
203		Canned, Frozen, and Preserved Fruits, Vegetables, and Food Specialties
	2034	Dried and Dehydrated Fruits, Vegetables, and Soup Mixes ⁴

(This industry group in its entirety, with a further description of the industries, can be found on page 73 of the SIC Manual.)

⁴ Proposed Regulation 1533.1, *Farm Equipment and Machinery*, states that the activities described in this classification only qualify as producing and harvesting activities if these activities are performed by a qualified person or a person who assists a qualified person. See the definitions of qualified person and person who assists a qualified person in the narrative portion of this LTA.

ATTACHMENT 2

**HISTORY OF THE
STATE GENERAL FUND PORTION
OF THE SALES & USE TAX RATES**

The following table includes the rate for the state general fund portion of sales and use tax. The rates are provided in both section 6051, *Imposition and rate of sales tax* and section 6201, *Imposition and rate of use tax*. (The use tax was not imposed until July 1, 1935.)

SALES TAX RATE	
Dates Property Sold/Purchased	State General Fund Portion of Sales and Use Tax Rate
January 1, 2002 and thereafter	5.0 percent
April 1, 1974 - December 31, 2001	4.75 percent
October 1, 1973 - March 31, 1974	3.75 percent
July 1, 1973 - September 30, 1973	4.75 percent
July 1, 1972 - June 30, 1973	3.75 percent
August 1, 1967 - June 30, 1972	4.0 percent
July 1, 1949 - July 31, 1967	3.0 percent
July 1, 1943 - June 30, 1949	2.5 percent
July 1, 1935 - June 30, 1943	3.0 percent
August 1, 1933 - June 30, 1935	2.5 percent

The January 1, 2002 sales and use tax rate increase of .25 percent is due to the conditions specified in sections 6051.45 and 6201.45 of the Revenue and Taxation Code.