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Agricultural Machinery Sales Taxes: Are California Farmers Getting A Fair Deal?

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A comparison of California's sales and use taxes for agricultural machinery and other agricultural inputs with sales and use taxes in other states is the focus of this article. This comparison reveals that California's taxation of agricultural machinery sales is among the highest in the nation. California sales tax treatment for other agricultural inputs is more in line with other states. Among the major non-durable agricultural inputs, California taxes only the sale of chemicals. Other agricultural inputs, including feed, seed, plants (except perennials), fertilizers, livestock, drugs and medicines are exempt from California sales and use taxes.

Federal taxes are assessed in a uniform manner, but the amount and mix of state income, property and sales taxes vary significantly by state. While most states employ all three taxes, there are exceptions. Five states, Alaska, Delaware, Montana, New Hampshire and Oregon do not impose general sales taxes at the state level. Seven states, Arkansas, Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not have individual income taxes. There is also significant variation among those states with sales and use taxes in terms of rates and items subject to taxation. Many states, including California, allow counties and cities to assess sales taxes, resulting in different tax rates depending on the location of the purchase or home of the purchaser. Rate variation by location combined with exemptions for particular items results in retail sales and use tax payments varying by farm enterprise and purchased inputs, as well as by location.

Sales Taxes for Agricultural Equipment

A comparison by state of sales and use taxes for new and used agricultural machinery sales and rentals, and parts sales, is presented in Table 1. It shows that, among the 45 states that have a statewide sales tax, 33 states exempt new agricultural machinery from sales taxes.

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California is one of the few states to impose sales taxes on agricultural machinery. In 1999, California dealers collected sales taxes totaling almost $57 million from their agricultural machinery purchasers.

Eight of the remaining 12 states that impose sales taxes on new agricultural machinery have reduced rates. Six of the eight states with reduced rates have reductions of 50 percent or greater for agricultural machinery sales. Only four states (California, Hawaii, Nevada and Washington) tax new agricultural machinery sales at the same rate as sales of other items. Recall that among these four states, neither Nevada nor Washington has state income taxes. Washington's statewide sales and use tax rate is 6.5% but local taxes can raise the total to 8.6% in some local jurisdictions. California has the second highest rate for agricultural machinery, with a statewide rate of 6%, and county, local and special district taxes that increase the rate to a range of 7.25 to 8.5%. Nevada's combined state and local tax rate ranges from 6.5 to 7%, while Hawaii's statewide general excise tax is 4%. A California farmer often pays the highest amount of sales taxes on a given new equipment transaction since California is the only state that taxes the gross amount of the sales price, even if there is a trade-in. All other states that tax agricultural machinery sales, even at a reduced rate, deduct the amount of any trade-in and apply the sales tax to the net price.

The sales tax situation for used agricultural machinery and for machinery rentals is similar to new machinery, but with one difference. Arizona, which exempts new agricultural machinery from sales taxes, charges the full sales tax rate on used agricultural machinery and on agricultural machinery rentals. Overall, 32 states exempt used agricultural machinery sales and rental from sales taxes, and eight of the remaining 13 states that impose sales taxes on new agricultural machinery have reduced rates. Parts for agricultural machinery are taxed in 15 states and only 6 of these states have a reduced rate for parts sales. States that exempt new agricultural machinery from sales taxes but tax parts include Arkansas, Georgia and Nebraska. Mississippi and Wyoming have reduced tax rates for new and used agricultural machinery but charge the full sales tax rate for parts.

Sales Taxes for Other Agricultural Inputs

The sales tax treatment of other major agricultural inputs varies by input and by state, but overall the situation is more favorable to agriculture than is the taxation of agricultural machinery. Only one state, Hawaii, taxes all agricultural inputs. Note that Hawaii's general excise tax of 4% has very few exemptions or exclusions. An examination by state for individual inputs reveals that Hawaii is the only state that imposes a tax on the sale of feed and seed used by agricultural operations. Hawaii is joined by Maine and South Dakota in taxing the sales of plants used in agriculture; and by Arizona and South Dakota in taxing fertilizers used by farmers. Only six states (Arizona, California, Colorado, Hawaii, Nevada and Wyoming) tax agricultural chemicals used by farmers.

Some Economic Impacts of Sales Taxes and Tax Exemptions

Economists, using competitive market assumptions, have demonstrated that sales and excise taxes reduce consumption and use of taxed items by changing relative price ratios. The impact on the quantity demanded of a taxed item depends, of course, on the availability and substitutability of alternative goods and inputs. Differential taxation of agricultural inputs can be expected to have several economic effects. In the case of agricultural machinery, for example, California's comparatively high tax rate certainly increases the cost of the machinery component of crop production when compared to other lower tax rate states producing the same crops.

Table 1. Taxes on Sales, Rentals and Parts for Farm Machinery

State	State Sales Tax Rate	Local Taxes	Typical Combined Tax Rate	Tax Rate on: Agricultural Machinery New	Agricultural Machinery Used	Parts	Rentals	Value of Trade-In
Alabama	4%	Yes	5 - 8%	1.5%	1.5%	1.5%	1.5%	No
Arizona	5%	Yes	5.5 - 7.2%	E*	TAX**	E	TAX	No
Arkansas	4.63%	Yes	6.125 - 8.50%	E	E	TAX	E	
California	6%	Yes	7.25- 8.125%	TAX	TAX	TAX	TAX	Yes
Colorado	3%	Yes	4 - 6.75%	E	E	E	E	
Connecticut	6%	No	6%	E	E	E	E	
Florida	6%	Yes	6 - 7.5%	3%	3%	3%	3%	No
Georgia	4%	Yes	5 - 7%	E	E	TAX	E	
Hawaii	4%	No	4%	TAX	TAX	TAX	TAX	No
Idaho	5%	Yes	5 - 7%	E	E	E	E	
Illinois	6.25%	Yes	7 - 8.75%	E	E	E	E	
Indiana	5%	No	5%	E	E	E	E	
Iowa	5%	Yes	6%	E	E	E	E	
Kansas	4.90%	Yes	5.9 - 7.4%	E	E	E	E	
Kentucky	6%	No	6%	E	E	E	E	
Louisiana	4%	Yes	7 - 9.5%	E	E	E	E	
Maine	5%	No	5%	E	E	E	E	
Maryland	5%	No	5%	E	E	E	E	
Massachusetts	5%	No	5%	E	E	E	E	
Michigan	6%	No	6%	E	E	E	E	
Minnesota	6.50%	Yes	6.5 - 7.5%	E	E	E	E	
Mississippi	7%	No	7%	1 - 3%	1 - 3%	7%	1 - 3%	No
Missouri	4.225%	Yes	4.725- 7.5%	E	E	E	E	
Nebraska	5%	Yes	5 - 6.5%	E	E	TAX	E	
Nevada	6.50%	Yes	6.5 - 7%	TAX	TAX	TAX	TAX	No
New Jersey	6%	No	6%	E	E	E	E	
New Mexico	5%	Yes	5 - 6.94%	2.5 -3.47%	2.5- 3.47%	2.5- 3.47%	2.5- 3.47%	No
New York	4%	Yes	7 - 8%	E	E	E	E	
N. Carolina	4%	Yes	6%	1%	1%	1%	1%	
N. Dakota	5%	Yes	6 - 7%	3%	1.5%	1.5%	3%	No
Ohio	5%	Yes	5.5 - 7%	E	E	E	E	
Oklahoma	4.50%	Yes	5 - 9.5%	E	E	E	E	
Pennsylvania	6%	Yes	6 - 7%	E	E	E	E	
Rhode Island	7%	No	7%	E	E	E	E	
S. Carolina	5%	Yes	5 - 6%	E	E	E	E	
S. Dakota	4%	Yes	5 - 8%	3%	3%	3%	3%	No
Tennessee	6%	Yes	7 - 8.75%	E	E	E	E	
Texas	6.25%	Yes	6.75- 8.25%	E	E	E	E	
Utah	4.75%	Yes	5.75 - 7.5%	E	E	E	E	
Vermont	5%	No	5%	E	E	E	E	
Virginia	3.50%	Yes	4.50%	E	E	E	E	
Washington	6.50%	Yes	7 - 8.6%	TAX	TAX	TAX	TAX	No
W. Virginia	6%	No	6%	E	E	E	E	
Wisconsin	5%	Yes	5 - 5.5%	4%	Yes	4 - 6%	3 - 5%	
Wyoming	4%	Yes	4 - 6%	3 - 5%	3 - 5%	TAX	3 - 5%	No

*E designates that the item is exempt from sales tax in that state.

**TAX indicates that the item is taxed at the full tax rate in that state.

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Large ticket farm machinery purchases include substantial sales tax payments. For example, a California farmer who purchased a tractor for $100,000 in 1999 paid another $7,250 in sales taxes.

The expected producer reaction to higher agricultural machinery prices is to attempt to substitute other inputs for machinery, to choose crops with lower machinery requirements, and to purchase less machinery, although we do not know how much less. California farmers and ranchers purchase significant amounts of agricultural machinery from sellers in other states for use in California. Since most of this agricultural machinery is not subject to sales taxes when purchased in other states, it is subject to California's use tax when brought into California. A recent survey of California farm equipment retailers asked each dealer to estimate the value of new and used equipment purchased out-of-state in 1999 by producers located in the dealer's primary market area. Separate estimates were made for new and used machinery and for brands carried by the dealer and for other brands. After removing overlaps for brands and market areas, dealer respondents estimated that California producers purchased over $103 million worth of new and used farm equipment in other states for use in California during calendar year 1999. This is almost 17 percent of estimated total new and used agricultural equipment purchases by California producers.

California's sales and use tax on farm machinery and equipment raises significant revenues that are shared by the state, counties, cities and special tax districts. The basic state, county and city tax rates are 6.00%, 0.25% and 1.00%, respectively. Special tax districts impose a tax of up to 0.50% that is added to the basic statewide sales and use tax of 7.25%. Note that a particular location may be in more than one tax district, producing the maximum combined local tax rate of 8.50% shown in the table. Based on a recent survey, California farmers purchased almost $785 million worth of new and used agricultural machinery, parts and rentals from California dealers during 1999 and another $103 million of new and used agricultural machinery from out-of-state for total taxable purchases of $888 million. Using the basic statewide sales tax rate of 7.25%, California farmers had a sales and use tax obligation for agricultural machinery of over $64 million in 1999.

California consumers and farm machinery purchasers will get a small tax break during calendar year 2001. Effective January 1, 2001, California's minimum combined state, county and local sales and use tax rate decreased from 7.25% to 7.00%. This was a result of 1991 legislation that requires a 0.25% reduction in the statewide sales and use tax rate if the state reserves exceed 4% of general fund revenues for the prior fiscal year and are estimated to do so for the current year. The same 1991 legislation requires that the 0.25% tax be re-imposed the year following any November 1 that reserves are again estimated to fall below 4% of general fund revenues.

As mentioned, California is the only state that taxes the gross amount of the sales price for agricultural machinery, even if there is a trade-in. A very conservative estimate placed 1999 California agricultural machinery trade-ins at about $31 million. Thus, this "double taxation" cost California farmers almost $2.25 million in sales taxes during 1999.

Bringing California sales and use tax treatment of agricultural machinery and parts sales in line with other states has significant cost implications for California farmers. Assuming that 1999 was a normal year, total exemption for farm machinery, equipment and parts sales and trade-ins would reduce annual sales and use taxes by over $64 million. This would put California farmers on par with their competitors in 38 other states and would be a significant step toward improving California agriculture's ability to compete both nationally and internationally. Even partial exemption from sales taxes, as occurs in eight other states, would help California farmers compete. Reduced sales taxes would also increase sales by California agricultural machinery dealers, increasing their employment and local economic contributions.

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