

FORAGE PRODUCERS AND THE INDIANA SALES TAX*

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Tax increases, like the recent increase in the Indiana sales/use tax from 6% to 7%, attract the attention of many individuals. According to the Indiana Code, the person who acquires tangible personal property in a retail transaction is liable for the tax on the transaction and shall pay the tax to the retail merchant as a separate, added dollar amount. The retail merchant shall collect the tax as agent for the state. Thus, an Indiana forage producer can encounter the Indiana sales/use tax in two ways:

- 1.) As a purchaser of property subject to tax.
- 2.) As an individual making sales of property subject to tax.

Only retail sales of tangible personal property, not services or real estate, are subject to tax. Furthermore, there are a number of exemptions for farmers and agricultural production which can be confusing to both buyers and sellers.

* This article draws heavily on the Indiana Department of Revenue Information Bulletin #9, Sales Tax, "Agricultural Production Exemptions," January 2003 and 45 Indiana Administrative Code. These are available at <http://www.in.gov/dor/reference/files/sib09.pdf> and http://www.in.gov/legislative/iac/iac_title?iact=45. Appreciation is expressed to Alan Miller for helpful comments on earlier versions.

Purchases

The general rule for the application of sales or use tax is that a purchase of tangible personal property to be used in Indiana is subject to tax unless a specific exemption is available. The sales tax applies to purchases in Indiana, while the use tax applies to Indiana sales where sales tax was not charged at the time of purchase or out-of-state purchases which were not subject to sales tax or which were subject to a lower rate of sales tax than in Indiana. For example, an Indiana use tax of 2% would be due on an out-of-state purchase on or after April 1, 2008 which had been taxed at a sales tax rate of 5% by another state.

Sales Tax Information Bulletin #9 (January 2003) says there are "several exemptions from sales and use tax relating to agricultural production. The exemptions are limited to purchases of animals, feed, seed, plants, fertilizers, insecticides, fungicides, and other tangible personal property; and agricultural machinery, tools, and equipment **directly used in direct production of food or commodities that are sold for human consumption or for further food or commodity production.**" (emphasis added) The property purchased must be integral and essential to the production process of

food or commodities. In addition to directly using the property in direct production, the person acquiring the property must be a farmer. A “farmer” is one who is occupationally engaged in the commercial production of food or agricultural commodities for sale or further use in producing food or commodities for sale. Persons who do not intend to operate at a profit or who produce food and agricultural commodities as a hobby are not occupationally engaged in farming and their purchases are subject to tax.

Operations similar to pony farms, riding stables, or the production and raising of dogs and pets are not classified as farms for sales tax purposes. Information Bulletin #9 gives an example of an operation which raises animals to be used in laboratory research. Because the animals are not intended for nor are sold for human consumption, the operation cannot purchase animal feed exempt from tax. A second example involves the purchase of horses to be used as riding animals. Such a purchase would be taxable because the animals are not directly used in the direct production of food or agricultural commodities. Purchase of animals used for sporting purposes (e.g., racing and gaming horses) and their feed and other inputs are not exempt from sales tax under the agricultural exemptions.

There are a number of items which, although used in agriculture, are not directly used in direct production and do not qualify for the agricultural exemption. Wearing apparel, appliances, hand and power tools, lawn or garden equipment and any motor vehicle required to be licensed for highway use are some examples. Fencing materials and building materials are gray areas.

Fencing materials are taxable if the fence is used only as partition fence between adjoining landowners or to keep wildlife, stray animals, or trespassers from entering cropland or farm premise. However, fencing materials are exempt if used to confine livestock during breeding, gestation, farrowing, calving, nursing, or finishing. Building materials are taxable if used in the construction or repair of non-exempt buildings. Confinement livestock buildings which serve a breeding, gestation, farrowing, nursing, or finishing function are generally exempt.

Electricity used to dry forages is considered to be directly used in direct production and would be exempt from sales tax. If exempt use of electricity is the predominant use of electricity on a meter, the purchase of electricity is exempt. If the use of electricity is not predominantly exempt (less than 50%), the sales tax is paid to the utility and a claim for refund for the percentage of exempt use is filed with the Indiana Department of Revenue. The taxpayer must file Form ST-200 and submit it to the Department, and the Department then issues either an exemption letter if under 50% to file a claim for refund or a Form ST-109 if over 50%.

Sales

In general, the sales tax applies only to retail sales. Many of the sales made by farmers are “wholesale sales” rather than retail sales, and thus are not subject to sales tax. Wholesale sales, according to Sales Tax Information Bulletin #52 (September 1994), include sales of:

- 1.) Tangible personal property, other than capital assets and depreciable property, to a person who purchases the property for the purpose of reselling it

without changing its form. Sales of grain to grain merchandisers or sales of hay, other forages and some market livestock to dealers would be in this purchase for resale category of wholesale sales.

2.) Tangible personal property for direct consumption as a material in the direct production of other tangible personal property produced by the buyer in their business of manufacturing, processing, refining, repairing, mining, agriculture, or horticulture. Sales of corn, soybeans, and other grains and livestock to a processor, as well as forages to a qualifying farmer, would be examples of this type of wholesale sale.

3.) Tangible personal property to a person who purchases the property for incorporation as a material or integral part of tangible personal property produced by the buyer in their business of manufacturing, assembling, constructing, refining, or processing is also a wholesale sale. This would include sales of some livestock and other agricultural products for processing.

If an Indiana forage producer makes retail sales to purchasers who are not qualified for the agricultural exemptions or the other exemptions discussed above, the producer is required to collect and remit the sales tax to the Indiana Department of Revenue. These producers are considered to be Indiana Retail Merchants and must register with the Indiana Department of Revenue. Registration requires completion of Form BT-1 and an initial application fee of \$25. Registration must be renewed every two years, but the new certificate is generated automatically if no tax is due or returns are missing. For further information, go to <https://secure.in.gov/apps/dor/bt1/>.

All retail sales of tangible personal property for delivery in Indiana are presumed to be subject to sales tax unless proven otherwise. The burden of proof is on the buyer and also on the seller, unless the seller receives an exemption certificate (45 IAC 2.2-8-12). Typically a buyer qualifying for the agricultural exemption would provide Form ST-105, General Sales Tax Exemption Certificate, with the appropriate box checked to the seller. The seller is required to collect and remit sales tax unless the seller has received a properly completed exemption certificate or is able to prove that the purchaser actually used the item for an exempt purpose. Failure to comply may lead to penalties and interest charges for the producer. For further information on complying with the sales tax collection, reporting, and deposit requirements go to <https://www.intax.in.gov/Web/>.

Conclusions

Many of the inputs and machinery purchased by Indiana forage producers are exempt from sales tax if two conditions are met. First, the tangible personal property must be directly used in direct production of food or commodities or commodities which are sold for human consumption or for further food or commodity production. Second, the producer must be occupationally engaged in the production. Individuals who do not intend to operate at a profit or produce as a hobby are not eligible for the agricultural exemptions from sales tax.

Sales by Indiana forage producers are often wholesale sales which are not subject to sales tax. Other sales may qualify for the agricultural exemption and the seller should receive an

exemption certificate, Form ST-105, from the purchaser. However, some sales may be made to purchasers who fail to meet the conditions for the agricultural exemptions discussed above. Such sales are subject to sales tax and it is the seller's responsibility to collect the tax from the purchaser and remit it to the Indiana Department of Revenue. Failure to comply with Indiana sales tax law can cause serious difficulties for producers. (Not for publication)

Merchants, if the only reason for doing so is to sell corn to an ethanol producer.

Questions have been raised whether the seed, fertilizer, pesticides and other inputs directly used in the direct production of corn to be used for the production of ethanol would qualify as being nontaxable under the agricultural exemptions. Clearly ethanol is a product of agricultural origin, but it is not intended for human consumption as food. However, production of ethanol from corn involves a joint product, distiller's dried grains (DDGS), which is used as an animal feed. Furthermore, corn can be used in a variety of ways and it is not certain that corn grown under contract for ethanol production will necessarily be used for that purpose. Thus, it could be argued that the inputs directly used in the direct production of corn should be nontaxable under the agricultural exemptions even if the corn was eventually used for ethanol production.

Currently, Indiana Department of Revenue's policy is not to have farmers register as Retail Merchants. Sales of corn to an ethanol producer do not qualify for an agricultural exemption from sales tax, but they are exempt from sales tax under the manufacturing exemption. The Department does not require farmers to register as Retail