

HOUSE BILL REPORT

HB 2138

As Reported by House Committee On:

Finance

Title: An act relating to rural economic development.

Brief Description: Promoting rural economic development.

Sponsors: Representatives G. Chandler, Linville, Mulliken, Clements, Ericksen, Hatfield, Sump, Doumit, Morell, Grant, Pearson, Schoesler, Barlean, Buck, B. Chandler, Edwards and Jackley.

Brief History:

Committee Activity:

Finance: 3/8/01 [DPS].

Brief Summary of Substitute Bill

- An exemption or deferral from the retail sales and use taxes is provided to certain persons for the purchase or use of
 - Animal health products;
 - Propane or natural gas used to heat structures that house chickens;
 - Bedding materials used to accumulate chicken manure;
 - Machinery, equipment, and other items used in controlled atmosphere storage located in rural or distressed areas;
 - Services or property purchased to operate dairy nutrient management facilities;
 - Anaerobic digesters; and
 - Farming machinery and equipment, associated parts, and labor and services for associated repairs.

- An exemption from certain property taxes is provided to certain persons for
 - Machinery and equipment used in farming; and
 - Real and personal property for dairy nutrient management facilities.

- An business and occupation tax change of tax classification, exemption, or credit, is provided to certain persons for
 - The manufacturing of dairy products;
 - Minor assembly of pumps, motors, and compressors; and
 - Operating anaerobic digesters.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives Cairnes, Republican Co-Chair; Morris, Democratic Co-Chair; Berkey, Democratic Vice Chair; Roach, Republican Vice Chair; Carrell, Conway, Pennington, Santos, Van Luven and Veloria.

Staff: Mark Matteson (786-7145).

Background:

Retail Sales and Use Taxes

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax base includes goods and certain services. The tax is imposed at a 6.5 percent rate by the state. Cities and counties may impose a local tax at a rate up to a maximum of 3.1 percent; currently, local rates imposed range from 0.5

percent to 2.3 percent. Sales tax is paid by the purchaser and collected by the seller.

The use tax is imposed on items used in the state that were not subject to the retail sales tax, and includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The state and local rates are the same as those imposed under the retail sales tax. Use tax is paid directly to the Department of Revenue.

All items and services in the retail tax base are taxed unless specifically exempted in statute. An exemption is provided to certain persons for sales or use of feed, seed, fertilizer, agents for enhanced pollination, spray materials, and chemical sprays used to prevent mold or fungus. The exemption is available to farmers for the purpose of growing or raising an agricultural product for sale or who are under contract with a nonprofit entity or the Department of Fish and Wildlife to improve wildlife habitat. The exemption is also available to persons who are participating in one of several federal conservation or habitat development programs.

Property Taxes

All real and personal property in this state is subject to property tax each year based on its value unless a specific exemption is provided by law.

The state imposes an annual property tax. The maximum tax rate is \$3.60 per thousand dollars of market value. The amount of the state property tax is also restricted by the property tax revenue limit. This limit requires the state to reduce its property tax rate as necessary to limit the total amount of property taxes to the highest property tax amount in the three most recent years plus inflation plus an amount equal to last year's tax rate multiplied by the value of new construction in the state. This limit has reduced the state's market value property tax rate to \$2.83 for taxes to be collected in 2001.

In general, the real and personal property of farmers or persons that provide services to farmers are subject to property taxes. However, certain exemptions are provided on certain personal property. For example, all agricultural products produced for sale on a farm are exempt from personal property taxes.

Business and Occupation Taxes

Every person engaging in a business activity in Washington must pay a business and occupation (B&O) tax measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business. Persons engaged in business as manufacturers pay a tax equal to the value of their products multiplied by 0.484. Persons engaged in wholesale sales are assessed the tax rate of the gross proceeds of the sales multiplied by 0.484. Revenues from the B&O tax are deposited in the state general fund.

Various manufacturers have been specifically exempted from the primary B&O manufacturer tax rate and have been assessed a lower B&O rate. Examples of manufacturers paying the lower rate of 0.138 percent include the manufacturers of flour, pearl barley, canola byproducts, sunflower oil, raw seafood, and preserved fruits and vegetables.

Farmers that raise or cultivate agricultural products for sale at wholesale are exempt from the B&O tax. Persons that provide services to farmers in general must pay B&O taxes on gross receipts; however, a deduction is allowed to any person for income received from washing, sorting, and packing fresh or perishable horticultural products for farmers.

Livestock Pharmaceuticals

A number of pharmaceuticals and other substances are utilized in raising livestock to yield high-quality products. Substances used to optimize animal production are subject to retail sales and use taxes, even if purchased by farmers.

Dairy Product Manufacturer B&O Rate

The producers of dairy products are assessed the primary manufacturer B&O tax at 0.484 percent.

Sales Taxes on Heating Inputs for Poultry Farming

Retail sales and use taxes apply to items that are indirectly involved in the raising of poultry, such as fuel to regulate the temperature of chicken housing, or materials involved in the removal of manure.

Manufacturing of Assembled Products; Controlled Atmospheric Storage

Manufacturing is broadly defined for purposes of the tax code, and includes all activities that produce a "new, different, or useful substance or article." Assembly of products from component parts is manufacturing, even if the amount of labor involved is small compared to the value of the components. For example, bolting together pumps and motors to make a single piece of equipment is manufacturing.

Certain agricultural products are maintained in controlled atmosphere storage,– warehouses in which the environment is controlled to preserve the product until the time at which the product is marketed or otherwise sold or moved.

Dairy Nutrient Management

In 1993 the Legislature passed the Dairy Waste Management Act to establish a process that provides for the effective management of dairy waste that affects the quality of

surface or ground waters in the state. In 1998 to address continuing concerns about impacts on surface or ground waters, the Legislature passed the Dairy Nutrient Management Act, amending the 1993 act. The 1998 legislation provided that every licensed dairy farmer develop a dairy nutrient management plan, and that every dairy farm be inspected at least once every two years. Plans must be approved by conservation districts no later than July 1, 2002, and an approved plan must be certified by a dairy producer and corresponding district that the plan is being used as intended no later than December 31, 2003.

In implementing the Dairy Nutrient Management Act, dairy farmers utilize facilities that contain and process manure and other dairy nutrients. These facilities include lined lagoons, holding tanks, pipes, pumps and other equipment used to handle and treat nutrient outputs. Another type of facility for the processing of cattle manure is an anaerobic digester, used to produce methane, carbon dioxide, and dried manure using bacteria in a decomposition process within a closed, oxygen-free container.

Farming Machinery and Equipment and Sales and Use Taxes

Machinery and equipment that is purchased or used by a farmer in farming operations is generally subject to the retail sales and use taxes. An example of an exemption from sales and use taxes that is related to agriculture is an exemption provided to persons for the purchase or use of property and equipment used in the business of processing fresh fruit, vegetables or fish, if the equipment is leased by the original owner under the terms of a sale/leaseback transaction.

Summary of Substitute Bill:

Livestock Pharmaceuticals

The exemption from retail sales and use taxes provided to farmers and persons involved in certain habitat and conservation programs for certain agricultural input purchases is extended to include sales of substances used to optimize animal production, including vaccinations, antibiotics, parasite treatments, approved animal pharmaceuticals, and other health products.

Personal Property Taxes on Farming Machinery and Equipment

Machinery and equipment owned by a farmer and used exclusively in farming activities to grow agricultural products is exempt from the state property tax. The farmer continues to pay local property taxes on the machinery and equipment. The state property tax is reduced by the amount of the exemption. The exemption first applies for 2003 property taxes

Dairy Product Manufacturer B&O Rate

The rate of the B&O tax on manufacturing dairy products and dairy by-products such as whey and casein, or selling the same to a purchaser who transports the products out of state is reduced from the current 0.484 percent to 0.138 percent. The seller of dairy products must maintain a business record, as prescribed by the Department of Revenue, as proof of sale to a person who transports the dairy products out of state.

Sales Taxes on Heating Inputs for Poultry Farming

A retail sales and use exemption is provided for the purchase or use of propane or natural gas used to heat structures that house chickens that are sold as agricultural products. In addition, the purchase or use of bedding materials that are used to accumulate and facilitate the removal of chicken manure are exempted from sales and use taxes. Bedding materials are defined as wood shavings, straw, sawdust, shredded paper, and other similar materials.

To receive an exemption provided under this bill, the buyer must present an exemption certificate. The seller is required to retain a copy on file.

Manufacturing of Assembled Products; Controlled Atmospheric Storage

The manufacturing B&O tax does not apply to assembly of motors, pumps, compressors, and related equipment, if some of the equipment and accessories are purchased from another person, and the amount paid for the components is at least 80 percent of the value of the assembled product.

Controlled atmosphere storage warehouses are added to the list of qualified buildings that are eligible investment projects under the chapter that provides sales tax deferrals for investment projects in rural areas. Machinery and equipment that is a necessary part of a controlled atmosphere storage warehouse is also eligible for the deferral.

Dairy Nutrient Management

An exemption from retail sales is provided to licensed dairy farmers for the purchase of services associated with the operation of dairy nutrient management equipment and facilities that are used exclusively to comply with a dairy nutrient management plan. An exemption from retail sales and use taxes is provided for the purchase of personal property that becomes a component of the dairy nutrient management equipment or facilities. An exemption is available only after a dairy nutrient management plan has been certified.

An exemption from retail sales and use taxes is provided to persons who establish or operate anaerobic digesters primarily for the treatment of dairy manure. The exemption

also applies to services purchased for installing, constructing or repairing an anaerobic digester, and to purchases of items that become components of digesters.

A credit against B&O tax liability is provided to persons who are eligible for and take the sales and use exemption associated with the purchase or use of anaerobic digesters or associated services or components. The credit is equal to 50 percent of expenditures on the construction of or components associated with anaerobic digesters, for which a sales & use tax exemption was taken. No application is necessary to obtain the credit, but persons must maintain records to allow the Department of Revenue to verify eligibility. Credit may not be taken in excess of taxes owed, and no unused credit may be carried over.

An exemption from property taxes for up to six assessment years is provided to eligible persons for all real and personal property that is defined as either dairy nutrient management equipment and facilities or as anaerobic digesters. As with the sales and use tax exemption, the exemption for dairy nutrient management facilities is available only to licensed dairy farmers, while that for anaerobic digesters is available to any person that operates a digester primarily for the treatment of dairy manure.

The property tax exemption associated with dairy nutrient management equipment and facilities is contingent on the completion of all construction and installation prior to the end of 2003 and on approval of a claim for exemption submitted to the local county assessor. The claim must be filed before November of each year to receive an exemption from taxes levied for collection the following year. The claimant must certify that the property for which an exemption is sought is being used under a certified dairy nutrient management plan or, if an anaerobic digester, primarily for the treatment of cattle manure.

Farming Machinery and Equipment and Sales and Use Taxes

An exemption from retail sales and use taxes is provided for the sales and use of machinery and equipment for farming activity; parts for machinery and equipment for farming activity; and labor and services for the repair of machinery and equipment for farming activity.

Substitute Bill Compared to Original Bill:

The substitute bill makes technical corrections to make proper reference to the definition of a farmer (section 2) and to clarify that the state property tax will be reduced so that the exemption will not cause tax shifts onto other taxpayers (section 3).

Appropriation: None.

Fiscal Note: Requested on March 12, 2001.

Effective Date of Substitute Bill: Ninety days after adjournment of session in which bill is passed.

Testimony For: None.

Testimony Against: None.

Testified: None.