



Legislative Fiscal Bureau

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February 14, 2006

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 646: Sales and Use Tax Exemptions for Tangible Property Used in the Business of Farming

Assembly Bill 646 would provide nonrefundable individual income and corporate income and franchise tax credits for sales taxes paid on the purchase of tangible personal property used in the business of farming. AB 646 was introduced on August 30, 2005, and referred to the Assembly Committee on Agriculture. Assembly Substitute Amendment 1 to AB 646, which would convert the proposed income and franchise tax credits to sales and use tax exemptions, was recommended for passage by the Committee on Agriculture on September 15, 2005, on a vote of 13 to 0. On September 27, 2005, the Assembly passed ASA 1 to AB 646, as amended by Assembly Amendment 1 (which would amend the list of businesses considered to be farming for purposes of the sales and use tax exemptions to include "silviculture"). On November 29, 2005, the Senate Committee on Agriculture and Insurance recommended concurrence, on a vote of 5 to 2. The bill, as passed by the Assembly, was subsequently referred to the Joint Committee on Finance.

CURRENT LAW

Under current law, the 5% state sales and use tax is imposed on all sales of tangible personal property, unless specifically exempted, and on a number of services identified in the statutes. The statutes provide sales tax exemptions for the following items used in agricultural production:

- Tractors and machines, including accessories, attachments, and parts, used exclusively and directly in the business of farming, including dairy farming, agriculture, horticulture, floriculture, and custom farming services. [s. 77.54(3)(a)].

- Seeds, plants, feed, fertilizer, pesticides and related chemicals, livestock, farm work stock, poultry, wire, twine, animal bedding, plastic sheeting, and certain containers used exclusively in the business of farming [s. 77.54(3m)].
- Livestock semen used for artificial insemination [s. 77.54(27)].
- Fuel and electricity sold for use in farming [ss. 77.54(30)(a)3 and 5].
- Medicine used on farm livestock, not including workstock [s. 77.54(33)].
- Milkhouse supplies used exclusively in producing and handling milk on dairy farms [s. 77.54(34)].
- Animal tags and standard milk samples sold by the Department of Agriculture, Trade and Consumer Protection [s. 77.54(42)].

In addition, veterinary medical and hospitalization services are not taxable services in Wisconsin.

The following items are specifically excluded from the exemption for farm tractors and machines under s. 77.54(3)(a): (a) motor vehicles for highway use; (b) personal property that is attached to or becomes part of real property or becomes an addition to, component of, or capital improvement of real property; and (c) tangible personal property that is used or consumed in constructing buildings or in the alteration, repair, or improvement of real property. However, the statutes provide in a subsequent paragraph [s. 77.54(3)(c)] that, for the purpose of the exemption, the following items retain their character as tangible personal property regardless of the extent to which they are fastened to, connected to, or built into real property: (a) auxiliary power generators; (b) bale loaders; (c) barn cleaners and elevators; (d) conveyors; (e) feed elevators and augers; (f) grain dryers and grinders; (g) milk coolers; (h) milking machines, including piping, pipeline washers, and compressors; (i) powered feeders; and (k) silo unloaders. As such items retain their characteristics as tangible personal property, they are not excluded from the sales tax exemption for machines, even when they become attached to or part of real property.

Section 77.54(3)(a) specifies that the business of farming includes dairy farming, agriculture, horticulture, floriculture, and custom farming services. In addition, the Wisconsin Administrative Code provides the following relevant definitions:

Dairy Farming. Dairy farming means the business of feeding and raising cattle and other milk producing animals, but does not include operations such as pasteurizing, homogenizing, or making butter, cheese, or ice cream.

Farming. Farming means the business of producing food products or other useful crops by tilling and cultivating the soil or by raising cattle, sheep, llamas, poultry, domesticated rabbits, or other animals which produce a food product or which are themselves a food product. In addition, consistent with chapters 29 and 94 of the statutes, "farming" includes: (a) raising earthworms, pheasants, foxes, fitch, nutria, marten, fisher, mink, chinchilla, rabbit, caracul, and bees; (b)

producing honey products by a beekeeper of 50 or more hives; (c) commercial raising of fish for food; (d) commercial breeding and raising of horses and llamas for sale; and (e) raising ginseng, mushrooms, and sod.

Farming does not include: (a) home gardening and other noncommercial activities; (b) breeding or raising dogs, cats, other pets, or animals intended for use in laboratories; (c) operating sporting or recreational facilities, such as riding stables or shooting preserves; (d) operating stockyards, slaughterhouses, or feed lots (as described below); (e) lumbering, logging, and pulpwood and sawmill operations; (f) milling and grinding grain; and (g) preparing sausage, canned goods, jellies, juices, or syrup.

Feed Lot. Feed lot means a restricted area containing pens or lots where livestock are held and fed. A person who holds livestock in a feed lot is engaged in farming only if the livestock is held for 30 days or more.

Floriculture. Floriculture means the business of producing flowers, Christmas trees or other decorative trees, plants, or shrubs, including such operations as greenhouses.

Horticulture. Horticulture means the business of producing vegetables, vegetable plants, fruits, and nursery stock, including the operation of commercial nurseries and orchards but not businesses which hold stock for purposes other than propagation or growth. "Horticulture" does not include: (a) the business of servicing plants owned by others; (b) the raising of trees as timber; or (c) lumber or sawmill operations.

Under current law, the sales and use tax exemptions described above do not apply to the businesses of forestry and logging. However, a specific exemption is provided for off-highway, heavy mechanical equipment such as feller bunchers, slashers, delimiters, chippers, hydraulic loaders, loaders, skidder-forwarders, skidders, timber wagons, and tractors used exclusively and directly in the harvesting or processing of raw timber products in the field by a person in the logging business [s. 77.54(39)]. The current provision for logging equipment specifically excludes hand tools such as axes, chains, chain saws, and wedges from "heavy mechanical equipment" for purposes of the exemption.

SUMMARY OF BILL AS PASSED BY THE ASSEMBLY

AB 646, as passed by the Assembly, would amend the current sales and use tax exemption for tractors and machines, including accessories, attachments, and parts, used exclusively and directly in the business of farming [s. 77.54(3)(a)]. Under the bill, the exemption for the listed tangible personal property used in the business of farming would be expanded to include lubricants, nonpowered equipment, and all other tangible personal property. In addition, the exemption would apply not only in the case of property used exclusively and directly in the business of farming but also in the case of property that is consumed or loses its identity in the business of farming. The bill

would also clarify within s. 77.54(3)(a) that items specified in s. 77.54(3)(c) [described above under "Current Law"] would be eligible for the exemption under s. 77.54(3)(a) regardless of the extent to which they are fastened to, connected to, or built into real property. This treatment would not be a change from current law, but would clarify current law by adding a reference to s.77.54 (3)(c) under s. 77.54(3)(a).

The bill would also delete the existing exemption for milkhouse supplies [s. 77.54(34)], as such tangible personal property would be included in exempt tangible personal property under the proposed modifications to s. 77.54 (3)(a).

Examples of currently taxable items that would become exempt under the bill include the following: (a) tools used in constructing farm buildings and fences and in making repairs to real estate, tractors, or other farm machines; (b) non-powered equipment such as applicators for fertilizers and insecticides, cutters, dairy scales, barn brooms, and machine parts; (c) vitamins; (d) supplements (including bovine growth hormone) and related supplies for livestock not currently exempt; and (e) lubricants, detergents, and miscellaneous additional supplies.

In addition to the changes described above, the bill would add the term "silviculture" to the types of business listed under s. 77.54(3)(a) that are to be included in the "business of farming." Silviculture, which would not be defined under the sales and use tax statutes, is defined in The American Heritage Dictionary of the English Language, Third Edition, as the care and cultivation of forest trees. A publication of the University Extension on forestry terms defines silviculture as the art, science, and practice of establishing, tending, and reproducing forest stands of desired characteristics based on knowledge of species characteristics and environmental requirements. Neither of these definitions refers to the harvesting of forest trees. Yet some industry representatives believe that harvesting is part of silviculture. This broader interpretation of the term is consistent with a description of the practice of silviculture as including the planting, thinning, and harvesting of timber that is provided in the Wisconsin Administrative Code related to Wisconsin's Shoreland Management Program.

It should be noted that, in addition to s.77.54(3)(a), which the bill would modify by adding the term "silviculture", there are three other farming exemptions under current law that list the types of businesses included as farming. If the intention is to apply all relevant farming exemptions to the business of silviculture, then the term should be added to the three additional exemptions [s. 77.54(3m), s. 77.54(30)(a)3, and s. 77.54(30)(a)5] for clarification of this intent.

The bill would take effect on the first day of the second month beginning after publication.

FISCAL EFFECT

Based on information provided by the United State's Census Bureau's Agricultural Census and estimates of the cost of existing exemptions associated with the business of farming, it is

estimated that the annualized fiscal effect of ASA 1 to AB 646, prior to the effect of AA 1, would be to reduce general fund sales and use tax collections by \$3.7 million annually. Assuming that the provisions would take effect April 1, 2006, it is estimated that the substitute amendment, prior to the effect of AA 1, would reduce general fund tax revenues by \$900,000 in 2005-06 and by \$3.7 million in 2006-07.

Examples of tangible personal property used in managing forests that would become exempt as a result of AA 1 include trees purchased for planting, tree planting machinery, pesticides, pesticide spraying equipment, pruning equipment, fertilizer, fertilizer spreaders. In addition, examples of tangible personal property used in harvesting trees that could qualify for the proposed addition of silviculture to the farming exemptions include fuel and electricity used in harvesting trees and certain property specifically excluded from the current exemption for logging equipment (axes, chains, chain saws, and wedges). Based on information provided by industry representatives, and assuming an effective date of April 1, 2006, it is estimated that AA 1 to the substitute amendment would reduce general fund tax revenues by \$600,000 in 2005-06 and by \$2,500,000 in 2006-07 and annually thereafter.

The total effect of the bill, as passed by the Assembly, is estimated as a reduction in general fund tax revenues of \$1.5 million in 2005-06 and \$6.2 million in 2006-07 and annually thereafter. In addition, it is estimated that county and special district taxes would be reduced by approximately \$500,000, on an annualized basis.

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