

POLICY NOTE

Yes, farmers pay taxes: A review of taxation imposed on Washington state farmers and ranchers

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Key Findings

1. Some critics claim Washington state farmers pay little or no taxes. That is not true.
2. Farmers and ranchers pay the B&O tax.
3. Farmers pay self-employment taxes and all state and federal payroll taxes.
4. All farmers pay sales or use tax on equipment. Washington is one of only two states to impose such a tax.
5. Like other wholesale industries, farmers do not pay retail sales tax on inputs, like feed, seed, fertilizer, equipment maintenance and parts, fuel, fencing, and similar items.
6. Washington state farmers and ranchers pay an average of \$403,410,000 in total property taxes statewide.
7. In all, the estimated 2018 taxes paid by farmers and ranchers in Washington totaled \$922,849,403.

Introduction

Agriculture is an intrinsic part of Washington state's economy, providing its second largest driver of growth, income, and jobs. Contrary to some claims, farmers provide a great deal of revenue for state and county governments through tax collection.

This study examines the claim that farmers and ranchers in our state “do not pay any taxes; none whatsoever.”¹ This study describes the various tax categories including Business and Occupation (B&O), property, retail sales, and self-employment and payroll taxes that farmers and ranchers pay. As the economics of farming becomes more difficult, this study provides a better understanding of where our food dollars go and how farmers and ranchers maintain their livelihoods while contributing to the larger state economy.

A close look at farms and ranches in Washington state demonstrates that, in addition to the taxes farmers and ranchers already pay, adding more taxation would significantly increase the financial burden lawmakers impose on farm and ranch operations in our state. Higher taxes would potentially push them over the threshold of sustainability and into bankruptcy. As is often noted, farmers and ranchers are “price takers,” not “price makers” meaning any additional fiscal burden imposed by the state through more regulation or taxation cannot be made up by passing the cost onto consumers.

Most Washington farms are small family enterprises with low profit margins

Washington state produces 300 commodities on more than 35,000 farms, totaling approximately \$9.6 billion in annual sales. The majority of those farms have fewer than 50 acres in production and generate \$2,500 or less a year in value by sales.²

1 “Senate Hearing – 2 SSB 5438 H-2A Ag Program 2,” TVW, Aired March 6, 2019. Senator John McCoy, 38th District – Tulalip.

2 “State Data – Washington,” 2017 Census of Agriculture, U.S. Department of Agriculture.

The data also show the “net cash farm income of operations – average per farm” is \$47,641, or about 67 percent of the median household income of \$70,979.³ The Washington State Department of Agriculture notes 92 percent of all farms are family operated.

That breaks down to 28,864 small farms operated by a family or an individual, compared to a partnership (2,396) or a corporation (3,694).⁴ It is important to note, however, that counted among the partnerships and corporations there are also family farm operations.

Over the last 20 years Washington state has lost 4,320 farms – an average of four per week – according to census data. The loss of farms can be attributed to either the sale of the farm to a developer or the consolidation of a farm with another entity.

Profit margins are small in farming. The USDA Economic Research Service notes that 69.9 percent of all farms in the United States operate in the “critical zone,” meaning a farm’s operating profit margin comprises less than 10 percent of the farm’s gross cash income.⁵ Comparatively, aerospace and defense have gross profit margins of 20 percent; homebuilding has a 20 percent gross profit margin, and software development has a 70 percent gross profit margin.⁶

The Washington State Department of Revenue’s “Agricultural Tax Guide” outlines the various taxes farms and ranches pay, including business license fees, business and occupation taxes, use taxes, and sales tax.⁷ As with all other property owners, farmers and ranchers must pay property taxes. Additionally, they must pay personal income taxes and contribute to Social Security and Medicaid if they earn more than \$400 a year.

The Business & Occupation tax

Despite some exemptions, farmers and agriculture-related businesses paid \$5,550,895 in 2018 in state Business and Occupation taxes.⁸ This includes 1,200 individual vendors who sell their agricultural products at farmers markets.⁹

Similarly, farmers who sell products manufactured from their own agricultural pursuits – for example, making candles from bees wax – also pay the state B&O tax.¹⁰ Service activities, like pesticide application and farmers who assist other farmers with occasional or seasonal work pay the B&O tax.

3 “Income by State,” Department of Numbers, at www.deptofnumbers.com/income/washington.

4 “State Data – Washington,” 2017 Census of Agriculture, U.S. Department of Agriculture.

5 “Profit margin increases with farm size” by Robert A. Hoppe, Amber Waves, Feb. 2, 2015, U.S. Department of Agriculture.

6 “Margins by Sector (US)” by Aswath Damodaran, New York University, January 2019, at pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html.

7 “Agriculture Tax Guide,” Washington State Department of Revenue, at dor.wa.gov/doing-business/business-types/industry-guides/agriculture-tax-guide/overview-taxes-applying-farming.

8 “Quarterly Business Review: Fourth Quarter,” Washington State Department of Revenue, 2018, at dor.wa.gov/sites/default/files/legacy/Docs/reports/2018/qbr418/Q418QBR.pdf.

9 “Revised Code of Washington,” 82.04.050, at apps.leg.wa.gov/rcw/default.aspx?cite=82.04.050.

10 “Revised Code of Washington,” 82.04.110 and 82.04.120, at apps.leg.wa.gov/rcw/default.aspx?cite=82.04.110 and apps.leg.wa.gov/rcw/default.aspx?cite=82.04.120.

Some agricultural activities are exempt from B&O taxes because they are not “manufacturing” as defined by law. Packing agricultural products, cubing hay or alfalfa, production, growing, or harvesting agricultural products, and processing fish are among the activities that are exempt from B&O taxes.

Agriculture is excluded from the B&O “manufacturing” tax because the primary function of agriculture is not to manipulate a pre-existing item but rather to grow a crop or nurture livestock to maturity. Additionally, wholesale sales of agricultural products farmers have produced on their farms are exempt from B&O taxes.

The retail sales tax

In total, farms in Washington state paid at least \$1,998,572 in retail sales taxes in 2018.¹¹

Farmers and ranchers actually pay far more than this in retail sales taxes. The total retail sales taxes reportedly paid by farms in 2018 does not reflect the millions in sales and use taxes paid for equipment purchases, because the Washington State Department of Revenue does not separate farm equipment purchases into a separate category for data collection.

Like any business, farmers and ranchers do not pay retail sales tax on raw materials, supplies, and other inputs. Tax-exempt wholesale supplies that are particular to farming include equipment and machinery replacement parts, livestock nutrient management equipment and facilities, agricultural employee housing, animal pharmaceuticals, livestock for breeding and cattle or dairy cows used to produce an agricultural product, diesel, biodiesel, and anaerobic digesters.¹²

The retail sales tax exemption mitigates the cost of equipment repair and maintenance when purchasing replacement parts and alleviates some of the cost of fuel. Replacement parts for equipment repair and maintenance are a critical part of farm operations.

Iowa State University Extension and Outreach estimates a tractor that has been operated an average of 400 hours a year for 15 years, will have had approximately \$50,000 in repairs and maintenance done over its lifespan.¹³ The same study estimates fuel costs of approximately \$26 per hour for diesel tractors. For the same 6,000-hour working tractor, that is \$156,000 in total fuel costs. A retail sales tax exemption saves farms approximately \$10,000 in taxes over the working life of one tractor.

Not everything farms purchase is covered by the retail sales tax exemption. Of particular note is the cost of retail sales tax on new equipment purchases.

11 “Quarterly Business Review: Fourth Quarter,” Washington State Department of Revenue, 2018, at dor.wa.gov/sites/default/files/legacy/Docs/reports/2018/qbr418/Q418QBR.pdf.

12 “Farm Tax Exemption Matrix,” Washington State Department of Revenue, at dor.wa.gov/sites/default/files/legacy/Docs/Misc/FarmExemptionTaxMatrix.pdf.

13 “Estimating Farm Machinery Costs,” Iowa State University Extension and Outreach, at www.extension.iastate.edu/agdm/crops/html/a3-29.html.

Washington state assesses retail sales tax on all new equipment sales but waives the additional 0.3 percent motor vehicle sales and lease tax. The average list price of a used tractor, depending on its size and horsepower, is approximately \$124,000. Taxes on a used tractor add about \$7,000 to the sale price.

Comparatively, a new tractor can cost up to \$250,000, meaning retail sales tax will add approximately \$16,250.

Use tax is closely related to retail sales tax. When a piece of farm equipment is purchased out of state, Washington state farmers must report the purchase and pay the assessed use tax value of the equipment after bringing it into the state. Use tax is assessed in lieu of sales tax.

Many farms and ranches replace equipment on a rotating schedule of five-to-10 years based on number of work hours. Sales of farm equipment in 2019 increased slightly compared to 2018, with more than 170,000 tractors sold in the United States alone.¹⁴ The upward trend in equipment sales means Washington farmers and ranchers remit more in retail sales tax to the state each year.

Property tax

In 2018 Washington farmers paid an estimated \$188,496,000 in property taxes for irrigated farmland and \$214,914,000 for non-irrigated farmland, for an estimated annual total of \$403,410,000 in property taxes paid to the state. This represents a significant portion (14%) of the total \$2.8 billion in property taxes the state collected.¹⁵

The Open Space Taxation Act¹⁶ allows qualifying landowners to apply for land to be valued at its “current use” rather than its “highest and best use,” meaning farmers and ranchers can have their property taxes assessed based upon the land’s value as existing farmland rather than future developed land.

The law allows for the maintenance, preservation, conservation, and continued existence of open space for “food, fiber, and forest crops” for the economic and social well-being of the state and its citizens. The purpose of the Open Space law is to protect farmers and ranchers from being taxed out of existence.

The average farm in Washington state is 400 acres, with an average taxable value of about \$1.16 million. Property taxes represent a significant expense for land-owning farmers and make up a significant contribution to the state’s coffers by the agricultural community.

The state authorizes other assessments based on property valuation, including school funding, hospital districts, road districts, rural fire districts, and more. Each of these entities receives funding from property taxes assessed to farms and ranches in the counties along with urban residents. There are over 1,200 local taxing jurisdictions in

14 “AEM United States Ag Tractor and Combine Report,” Association of Equipment Manufacturers. August 2019, retrieved Sept. 10, 2019, at www.globenewswire.com/news-release/2019/09/10/1913730/0/en/AEM-United-States-Ag-Tractor-and-Combine-Report-August-2019.html.

15 “Revenue at a Glance,” Washington State Department of Revenue, 2018, at dor.wa.gov/sites/default/files/legacy/Docs/Pubs/Misc/RevenueAtAGlance.pdf.

16 “Open Space Taxation Act,” Washington State Department of Revenue, July 2017, at dor.wa.gov/sites/default/files/legacy/Docs/Pubs/Prop_Tax/OpenSpace.pdf.

Washington state, many of which impose annual property taxes on farmers and ranchers.

In addition to the state legislature, county councils impose a significant yearly tax burden on farmers. The 2019 property tax rates for each county are depicted in a graph at the end of this publication:¹⁷

The average county property tax rate in Washington state is 1.19 percent. The 2018 State Agriculture Overview from the USDA¹⁸ notes our state has 14,700,000 acres of operating agricultural land. The USDA also shows irrigated agricultural land is worth approximately \$8,800 an acre, while non-irrigated acres are worth around \$1,400 an acre.¹⁹

Washington State University Extension Service²⁰ notes there are approximately 1.8 million irrigated acres of agricultural land in our state, leaving the remaining acres non-irrigated.

To get a better sense of what farmers pay on a local level, Whitman and Franklin counties provide examples of agricultural counties with differing types of agriculture collecting property taxes from farmers and ranchers.

Whitman County has the highest tax rate in Washington state (1.42 percent) and an average farm size of 1,240 acres.²¹ A non-irrigated farm of that size would be valued at approximately \$1,736,000 with property taxes calculated at \$24,651 a year. If there is a typical home on the property valued at \$260,000, the taxes on the home are approximately \$3,692. The farmer pays total taxes on the property of about \$28,343 a year.

Franklin County has a tax rate of 1.20 percent but many of its farms are irrigated and smaller in acreage. The USDA county profile shows the average farm in Franklin County is 797 acres. An irrigated farm of that size could be valued at approximately \$7,013,600, setting its property tax bill at \$84,163 a year. If a home – valued at \$260,000 – were situated on the land as well, it would add an additional \$3,120, for a total property tax of \$87,283 a year.

Most farms have additional buildings and property improvements that increase their assessed value, indicating that farmers pay even more in yearly property taxes than the examples given.

17 “Agricultural Land Valuation—Interest Rate—Property Tax Component,” Washington Administrative Code 58-30-262.

18 “2018 State Agriculture Overview,” U.S. Department of Agriculture, September 2019 at www.nass.usda.gov/Quick_Stats/Ag_Overview/stateOverview.php?state=WASHINGTON.

19 “Land Values 2018 Summary,” National Agricultural Statistics Service, U.S. Department of Agriculture, August 2018, at www.nass.usda.gov/Publications/Todays_Reports/reports/land0818.pdf.

20 “Irrigation in the Pacific Northwest,” Washington State University, at irrigation.wsu.edu/Content/Washington-Irrigation.php.

21 “2017 State and County Profiles – Washington,” Census of Agriculture, U.S. Department of Agriculture, 2019, at www.nass.usda.gov/Publications/AgCensus/2017/Online_Resources/County_Profiles/Washington/index.php.

Self-employment and payroll tax

Farmers who are self-employed pay the federal self-employment tax. The tax rate is 15.3 percent and has two parts: 12.4 percent for Social Security and 2.9 percent for Medicare. These are the same payroll taxes taken from worker paychecks by any employer. A farmer earning an average wage of \$47,641 annually will pay approximately \$7,300 in Social Security and Medicare payroll taxes, \$5,900 and \$1,381 respectively.

As applied to the 63,298 farmers and ranchers in Washington state it is estimated that they paid about \$461,890,000 in federal taxes to Social Security and Medicare in 2018.²²

Farmers and ranchers pay state and federal payroll taxes and workers' compensation fees for their employees.²³ Employers must also pay federal unemployment taxes for all employees. Because both state and federal payroll and unemployment taxes are paid by farmers, ranchers and other employers, they reduce the amount of money available to pay workers.

For example, a Washington state farmer or rancher employing full-time help and paying \$17.13 per hour or \$2,740 in gross wages a month per employee will pay \$2,537 annually in state unemployment insurance, workers' compensation fees, and paid family medical leave contributions. For small farms the fees imposed on labor may amount to about \$5,000 to \$10,000 annually. For a farm employing 2,500 workers, that equates to \$6,342,693 in employment fees paid on an annual basis, making less money available for worker paychecks.

Conclusion

The findings of this study demonstrate that farmers and ranchers in Washington pay a great deal of their yearly earnings in taxes. Studying the Department of Revenue's exemption rules creates the impression that farming and ranching businesses get tax breaks that other businesses can only hope for. That is a shallow and inaccurate reading of the tax code.

Farmers are only exempt from the retail sales tax in specific business-related instances and are exempt from B&O taxes only when participating in the wholesale marketing of their products, just like other industries. In most cases, farmers and ranchers pay the same taxes as other business and homeowners. Property, licensing, and payroll taxes make up the bulk of the taxes paid by farmers. In fact, based upon the conservative estimates in this study, farmers and ranchers paid approximately \$922,849,000 in taxes in 2018.

Farming and ranching are highly regulated businesses with directives for water use, soil conservation, pesticide application, labor and more. Farmers and ranchers have high input costs and considerable seasonal risk that other businesses do not have. In addition, farmers and ranchers often provide housing and transportation for employees, and incur large equipment purchases and maintenance costs. The regulatory costs imposed on farmers and ranchers are offset by limited tax exemptions.

22 "Table 46 and Table 47," 2017 U.S. Agriculture Census, U.S. Department of Agriculture, at www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1,_Chapter_2_US_State_Level.

23 "Unemployment Taxes," Washington State Employment Security Department, at esd.wa.gov/employer-taxes.



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When she is not in the office, you can find her helping with irrigation and other work on her family farm, shuttling kids to 4-H meetings, or working as the superintendent for the agriculture building at the Grant County Fair.

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Farmers and ranchers are not looking for a free ride. They want to pay their yearly share to the state treasury on a fair basis just like everyone else. As this study finds, however, it is not accurate to say that Washington farmers and ranchers pay little or no taxes at all.

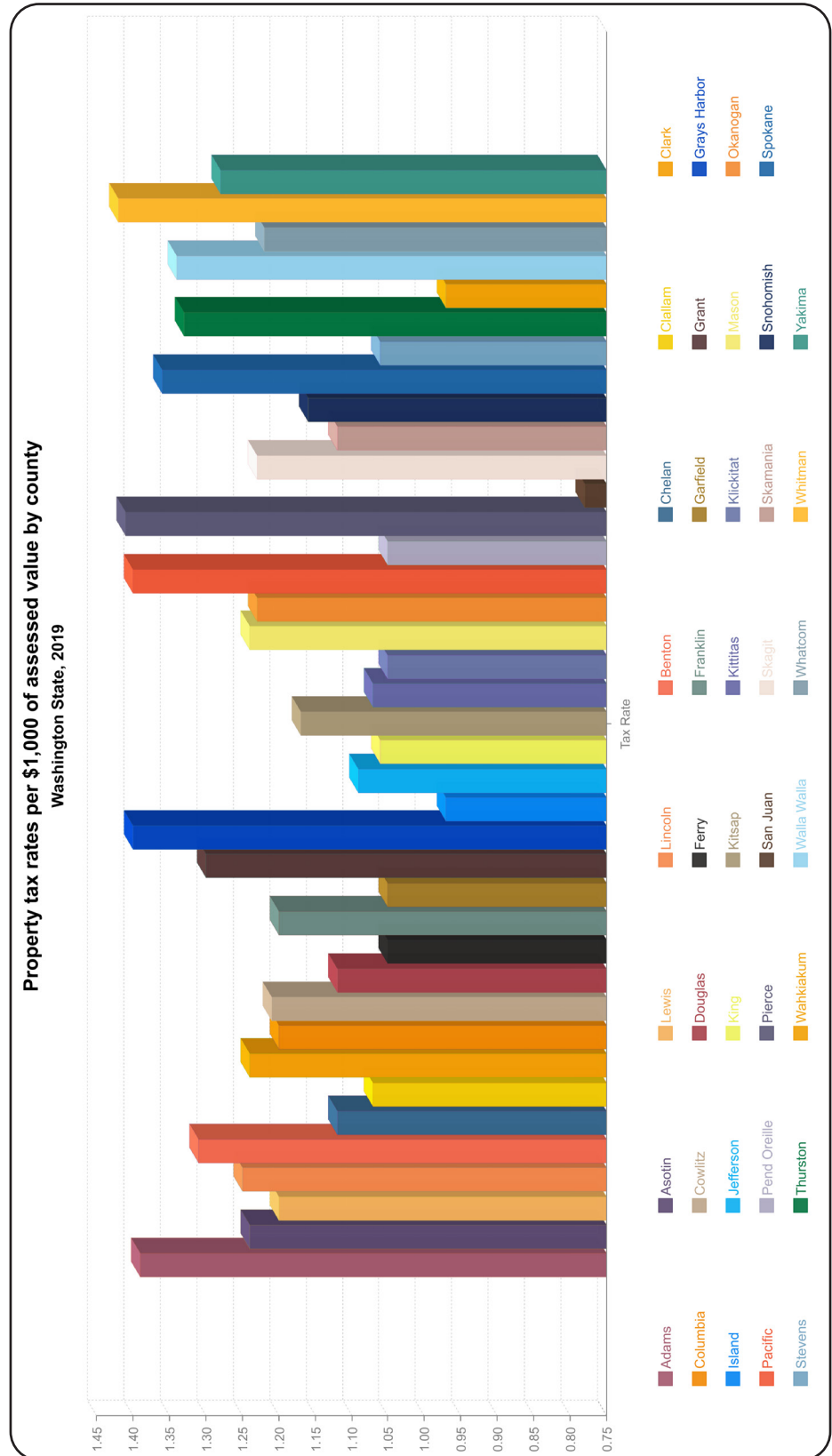


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