

# Farm Close-Out Sales Tax Exemption



OFFICE OF THE STATE AUDITOR

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C O L O R A D O

The Farm Close-Out Sales Tax Exemption exempts property previously used in farming or ranching operations from sales tax when the items are purchased at a farm close-out sale. Farm close-outs occur when a farmer or rancher is abandoning their farming or ranching operation and attempting to make full and final disposition of all of their tangible personal property used in the operation.

**The expenditure is likely meeting its purpose because it is being used by the state's farming and ranching industry. However, the application of the exemption to certain items can be inconsistent and the cost savings vary based on local sales and use tax policies.**

- Potential beneficiaries are generally aware of and receiving the exemption, though there may be inconsistencies in how the exemption is applied, such as on smaller equipment that could be used for agricultural or non-agricultural purposes.
- Other state-level exemptions cover many of the same items that are covered by the Farm Close-Out Sales Tax Exemption.
- The exemption's cost savings to the buyer vary based on the county and municipality where the buyer takes possession of the equipment and the local sales tax rate.
- While stakeholders told us they use the exemption, we could neither determine the extent to which it is used during eligible close-out sales nor how often it is applied.

## Policy Considerations

We did not identify any new policy considerations in this evaluation.

Tax Type:	<b>Sales</b>	Year Enacted:	<b>1945</b>
Expenditure Type:	<b>Exemption</b>	Repeal/Expiration date:	<b>None</b>
Statutory Citation:	<b>Section 39-26-716(4)(a), C.R.S.</b>	Revenue Impact (2020):	<b>We could not determine</b>

Purpose given in statute or enacting legislation? **No**



# Farm Close-Out Sales Tax Exemption

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## Background

Colorado imposes sales tax on purchases of tangible personal property within the state. **The Farm Close-Out Sales Tax Exemption (Farm Close-Out Exemption) exempts property previously used in farming or ranching operations from sales tax when the items are purchased at a farm close-out sale.**

Farm close-out sales occur when a farmer or rancher is abandoning their farming or ranching operation and attempting to make full and final disposition of all of their tangible personal property used in the operation. The sales are typically conducted by an auctioneer, but can be conducted by a farmer or rancher through a private sale. In order for property to qualify for the exemption, it must have been used in a farming or ranching operation. For example, agricultural equipment such as tractors, irrigation equipment, and baling materials are exempt. In addition, other non-agricultural property including, but not limited to, motor vehicles, general tools, and mowers could also be exempt as long as the property was used in a farming or ranching operation. Additionally, a farm or ranch owner must sign a written declaration that the property qualifies for the exemption and provide a copy to the buyer, and in cases when items are sold at auction, can provide it to the auctioneer. The exemption is generally applied by the seller at the time of the sale, or in the case of motor vehicles, when the county clerk registers the vehicle.

### Technical Note:

Statute defines “motor vehicle” as any self-propelled vehicle that is designed primarily for travel on the public highways and that is generally and commonly used to transport persons and property over the public highways. This does not include a farm tractor or off-highway vehicle.

Typically, sellers do not collect sales tax on the transaction and report the exemption to the Department of Revenue (Department) on Form DR 0100 after the purchase. Alternatively, if a purchaser pays sales tax at the time of the sale, they may request a refund from the Department. If a purchaser takes possession of the property in another state, Colorado sales tax does not apply, and therefore the exemption is not applicable.

**The exemption is likely intended to encourage the purchase of used agricultural equipment and supplies from Colorado farmers and ranchers who are closing their agricultural operation by lowering the after-tax cost of the purchase.**

The exemption was enacted in 1945 when the United States was involved in World War II and there was a need for additional agricultural production. Specifically, in Colorado, the number of farmers

decreased by approximately 7.4 percent between 1940 and 1945. During the same period, the U.S. Department of Agriculture (USDA) asked farmers in Colorado to increase their production of agricultural products to help the war effort. Therefore, the expenditure may have been originally enacted to encourage new producers in the industry by reducing the cost of equipment. The exemption has remained largely unchanged since.

Statute does not explicitly state the exemption's intended beneficiaries. We inferred that the intended direct beneficiaries are new and continuing farmers and ranchers. According to USDA data, there were approximately 39,000 farms in the state as of 2021 that could potentially benefit from the exemption. Agricultural producers who are closing down their operations likely also benefit, as the exemption lowers the total out-of-pocket cost to buyers, and may encourage higher auction bids of the outgoing producers' equipment.

We developed the following performance measures to evaluate the exemption:

- The extent to which stakeholders are aware of and correctly apply the exemption.
- The extent to which the exemption reduces the cost of farm and ranch equipment for buyers.

## Evaluation Results

**The expenditure is likely meeting its purpose because it is being used by the state's farming and ranching industry. However, the exemption's application to certain items can be inconsistent and the cost savings can vary based on local sales and use tax policies.**

**Potential beneficiaries are generally aware of and receiving the exemption.** As part of our last evaluation, conducted in 2018, we interviewed five auctioneer groups that conduct farm close-outs in Colorado and all were aware of the exemption. For this evaluation, we contacted two auctioneer groups and they confirmed that awareness was still high within the auctioneer industry. Auctioneers who specialize in agricultural equipment auctions reported that the exemption is important to the agricultural industry in the state. Stakeholders indicated that Colorado farmers often face financial constraints and operate on small profit margins, so the tax savings offered by the exemption provide a meaningful benefit. Farmers closing their operations are also aware that participating in a farm auction close-out sale can drive up the bids on their equipment, because purchasers know they will not have to pay sales tax and may be willing to bid a higher amount.

**While stakeholders told us they use the exemption, we could neither determine the extent to which it is used during eligible close-out sales nor how often it is applied.** The amount that Farm Close-Out Exemption sellers report to the Department is aggregated with several other agricultural sales tax exemptions (e.g., sales of livestock, feed, bedding, seeds, agriculture compounds, and pesticides [Section 39-26-716(4)(a-c) and 39-26-102(19)(c-g), C.R.S.]). Sellers are

not required to report how much of their exempt sales are due to the Farm Close-Out Exemption; therefore, we were unable to determine how many sellers have applied the exemption or the amount of sales tax that was exempted. As of 2021, the Department reported that these agricultural sales tax exemptions totaled \$20.9 million from about 6,200 filings. Overall, the exemption's revenue impact is likely a small portion of the \$20.9 million total, with two farm close-out auctioneers reporting that farm close-out sales generally occur infrequently. We were able to identify the revenue impact from the application of the exemption to motor vehicle sales for Tax Years 2019 through 2022 because these sales are reported to county motor vehicle offices; however, the impact of these sales is limited to only 55 motor vehicle purchases since 2019—with an annual average cost of \$4,650 to the State.

**Sellers may apply the exemption inconsistently.** The auctioneers we spoke with reported sometimes being uncertain about what items should be included in the exemption, especially for smaller equipment and tools that could be used for agricultural or non-agricultural purposes. For example, it is not always clear whether items in tool shops, spare tires used on tractors or farm vehicles, and tractors or vehicles that have been scrapped and are no longer used in agricultural production should be included in the exemption. Some stakeholders reported that, based on the judgement of the auctioneer or farmer, there may be inconsistencies in the items that are exempted.

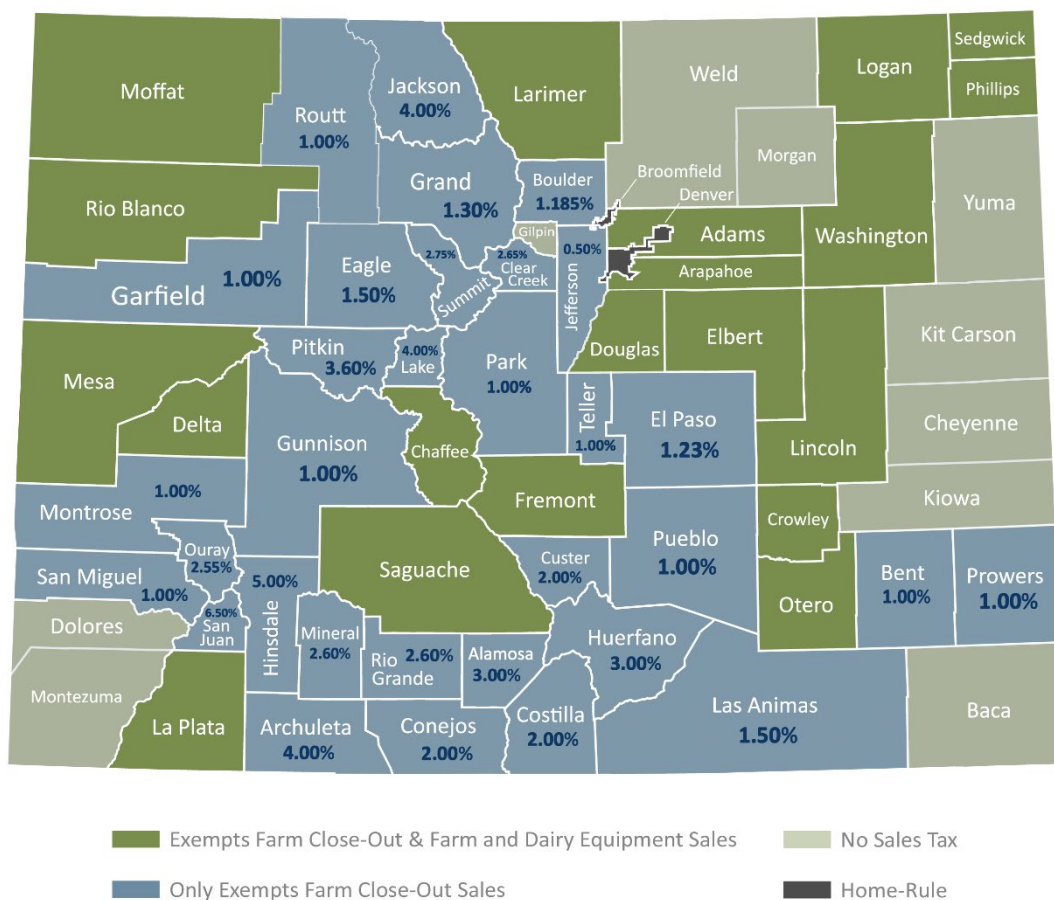
**Other state-level exemptions cover many of the same items that are sold at farm close-out sales.** Colorado has several other agricultural sales and use tax exemptions that were enacted after the Farm Close-Out Exemption, which means agricultural product sales like those mentioned previously, as well as farm equipment used for normal business operations, are already exempt from state sales tax. Based on conversations with stakeholders, most of what is sold at farm close-out sales is equipment that is also exempt from state sales tax due to the broader Farm and Dairy Equipment Sales Exemption [Section 39-26-716(4)(e), C.R.S.]. Because farm equipment is generally already exempt from sales tax during normal sales, the Farm Close-Out Exemption provides a relatively limited benefit at the state level. For example, sales of agricultural equipment, such as tractors, plows, and combines, are exempt from state sales tax under both exemptions. Although the Farm Close-Out Exemption may provide an unduplicated exemption for sales of some items that purchasers do not intend to use as part of an agricultural operation or that are not otherwise exempt, such as general tools, mowers, and on-road motor vehicles, these items likely make up a relatively small portion of property sold at farm close-out sales. We found that only eight other states have a sales tax exemption similar to the Farm Close-Out Exemption, but 32 exempt agricultural equipment used in farming and ranching operations. A likely reason that farm close-out sales exemptions are relatively uncommon in other states is that broader exemptions related to agricultural equipment cover many of the same items in those states, similar to Colorado's Farm and Dairy Equipment Sales Tax Exemption.

**The amount purchasers save varies based on local sales tax policies.** Statute requires cities and counties that have their sales tax collected by the State to provide the Farm Close-Out Exemption, but they are not required to provide the Farm and Dairy Equipment Sales Tax Exemption—and must opt into it by enacting a local ordinance. Additionally, home rule jurisdictions that collect their

own sales taxes can set their own tax policies independent from the State and are not required to provide either exemption. As a result, the benefit of the Farm Close-Out Exemption varies based on the local tax jurisdiction where the buyer takes possession of the equipment and the local sales tax rates. Specifically, all 62 Colorado counties for which the State collects sales tax are required to apply the Farm Close-Out Exemption. However, only 20 of these counties have adopted the Farm and Dairy Equipment Sales Tax Exemption, while an additional 10 have no sales tax, meaning that the Farm Close-Out Exemption provides an unduplicated benefit in 32 counties. The benefit the exemption provides can be as high as 6.5 percent or as low as 0.5 percent, depending on the county's sales tax rate, as shown on the Exhibit 1 map.

## Exhibit 1

### Sales Tax Rates in 32 Counties That Only Exempt Farm Close-Out Sales



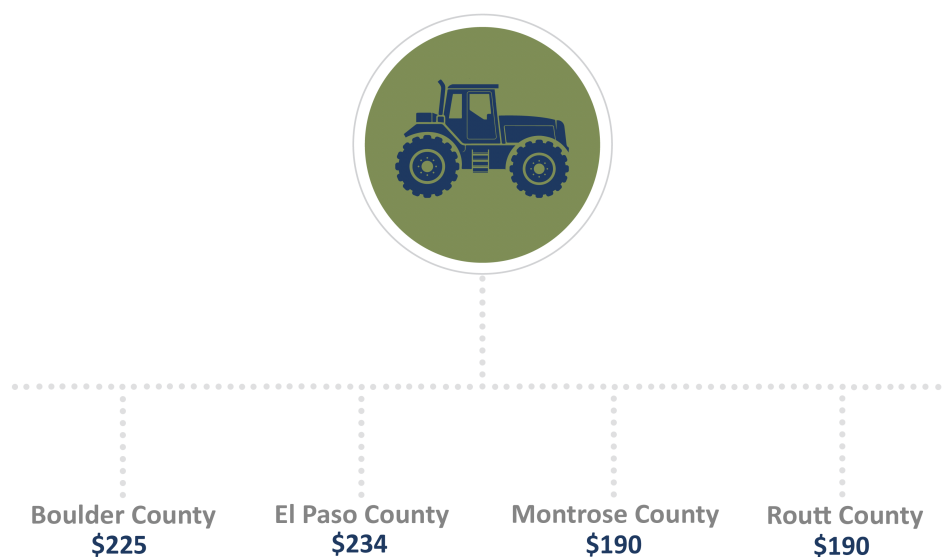
Source: Office of the State Auditor analysis of local sales tax rates and county exemptions of the Farm Close-Out and Farm and Dairy Equipment exemptions from the Department of Revenue's Sales and Use Tax Simplification Lookup Tool as of March 2023.

Based on data from the USDA's 2017 Agriculture Census, we determined that about 31 percent of the state's farms (12,200 of 38,900) were in counties with only the Farm Close-Out Exemption. Overall, the exemption's tax benefits could provide a strong enough incentive to encourage some

farmers and ranchers to participate in farm close-out sales, especially if they plan to purchase more expensive equipment. For example, as shown in Exhibit 2, a farmer purchasing a \$19,000 used tractor at a farm close-out sale in any of the four counties with the largest number of farms, and only the Farm Close-Out Exemption, would save \$210, based on the average local tax rate for these four counties. This would be in addition to the \$551 in state sales taxes saved due to the Farm Close-Out Exemption or the Farm and Dairy Equipment Exemption, which would both exempt the purchase from the 2.90 percent state sales tax.

## Exhibit 2

### County Sales Tax Savings on a \$19,000 Tractor in the Four Counties with the Most Farms and Only the Farm Close-Out Exemption



Source: Office of the State Auditor analysis based on local sales tax rates from the Department of Revenue.

Similarly, the Farm Close-Out Exemption provides an unduplicated exemption in 119 of the 126 municipalities with their sales taxes collected by the State because these jurisdictions have not adopted the Farm and Dairy Equipment Exemption. These municipalities have sales tax rates from 1 percent up to 5 percent and the exemption provides a corresponding local tax savings. Additionally, 50 of the State's 100 home rule jurisdictions with a sales tax, provide a similar unduplicated exemption for farm close-out sales, although these exemptions are established and administered independently from the State's exemption. The sales tax rates in these jurisdictions range from 1.5 percent up to 7 percent. As a result, the Farm Close-Out Exemption's cost savings also vary based on the city or town where the buyer takes possession of the equipment and the local sales tax rate. However, data on the location of the sales or where the buyer takes possession of the items are not available; therefore, we could not determine how often sales occur in a county or municipality with a sales tax exemption.

As a hypothetical example of how tax rates and local exemptions can impact cost savings, Exhibit 3 shows the cost savings on the sale of a \$19,000 tractor in two jurisdictions in Boulder County. Nederland, which has a sales tax rate of 4.25 percent, is required to exempt farm close-out sales versus the City of Boulder, which has a sales tax rate of 3.86 percent, is a home rule city and does not exempt these sales.

### Exhibit 3

The Farm Close-Out sales tax exemption provides a larger cost-savings to purchasers in local jurisdictions that are required to provide the exemption.		
	Town of Nederland (Local Exemption)	City of Boulder (No Local Exemption)
State Sales Tax Rate	2.9%	2.9%
City Sales Tax Rate	4.25%	3.86%
Total Rate Exempted <sup>1</sup>	7.15%	2.9%
Cost Savings	\$1,358.50	\$551.00

Source: Office of the State Auditor analysis of the cost savings based on the state and municipality sales tax rate that is exempted.

<sup>1</sup> The Town of Nederland and City of Boulder are both located in Boulder County which is required to exempt Farm Close-Out sales from the county tax rate of 1.185%, therefore we did not include the county exemption in the comparison.

## Policy Considerations

We did not identify any policy considerations for the Farm Close-Out Exemption. In the previous evaluation of this expenditure in 2018, we included a policy consideration that the General Assembly may want to review, and if necessary, amend the language of the exemption to reflect its tax policy preferences concerning the inclusion of motor vehicles in the exemption. In 2022, House Bill 22-1023 would have excluded motor vehicles that are subject to registration requirements from the Farm Close-Out Exemption. The House Finance Committee voted to postpone the bill indefinitely and therefore, the General Assembly did not take any legislative action on this policy consideration. Due to the low revenue impact of exempting motor vehicles from sales tax in the event of a farm close-out sale (less than \$9,000 in 2022), which is information that was not available at the time of the prior evaluation, we are not repeating that policy consideration in this evaluation.



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