

Sales and Use Tax: Application to Kentucky Farmers

AEC Extension No: 105
September 1993

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Kentucky's 6% sales tax, although a low amount, can add up to be very costly if neglected and not paid. It also can be expensive if paid on items which are tax exempt. As a general rule Kentucky sales and use tax law assumes that all gross receipts of a retailer, including farmers, are subject to the tax unless an exemption exists. An exemption exists for food and food products, and products that are used for the production of food items. Therefore, a farmer can sell grains, oilseeds, forages, or these products can be used for the production of livestock which in turn will produce meat, eggs or milk products. Since meat, eggs or milk products are sold, the requirement of collecting sales tax is relinquished. Transactions relating to tobacco production are subject to sales and use tax because tobacco is not considered food. Horses are not considered livestock and are not used for human food consumption. Therefore, if a farmer sells grain, straw, machinery, etc. to a horse farm where the product is used in the production and raising of horses, the *seller* must charge, collect, and remit sales tax on the sale to the Kentucky Department of Revenue.

If hay or any other farm commodity is sold to a broker, feed store or local cooperative, for resale purposes then the seller must request that the buyer complete a resale certificate unless the buyer has been in the business of reselling farm commodities for years. If the purchaser *does not* use the purchased item for its stated use as being resold, it then becomes his/her responsibility to remit the sales tax.

Normally, farmers are required to remit the sales or use tax every three months. If they are required to

remit sales tax every quarter, they will receive a Form 51A102 from the Kentucky Revenue Cabinet that is due on the 20th of the month, the month following the quarter. Therefore, if sales tax is due quarterly, they will have to file the Form 51A102 before, April 20th, July 20th, October 20th and January 20th. Depending upon the situation, farmers may be required to file the sales tax form monthly.

It is important that farmers maintain a file of resale certificates and other certificates of exemption. Keep copies of resale certificates, agricultural exemption certificates, farm machinery exemption certificates, and certificates of exemption for on farm grain and soybean facilities for a minimum of 4 years if a sales and use tax permit number has been issued. If a farmer does not have a sales and use tax permit number then exemption certificates must be on file back to 1960 or when the business started, whichever is later. The certificates of exemption must be kept with other farm records in case of an audit. Where exemptions do not exist **the seller is always held responsible for the collection and remittance of sales or use tax.** Delinquent payments are subject to a 2 percent per month penalty and interest. Presently, the interest charge on delinquent payments is 7 percent. Individuals who are delinquent in paying their sales taxes will find the penalties and interest mount up very fast.

SALES TO FARMERS -

Sales of tangible personal property to farmers for their use in their trade and business of farming are exempt from sales tax if the following occurs:

1. The farmer will use the tangible property in the trade and business of farming and
2. the farmer is regularly engaged in the occupation of tilling and cultivating the soil for the production of crops or in the business of raising or feeding livestock or poultry for the production of meat, eggs or milk.

Farm machinery purchased by farmers who use the machinery in the occupation of tilling and cultivating the soil for the production of crops or in the business of raising or feeding livestock or poultry for the production of meat, eggs or milk, is exempt from sales and use tax. The production of crops includes timber, flowers, fruits, shrubs, etc. Farm machinery includes all machinery **exclusively** used in the activities listed. Repair and replacement parts used on exempt machinery used **exclusively** for the production of food. The farmer must provide the retailer a Farm Machinery Exemption Certificate, Revenue Form 51A148, in order to be exempt from the sales and use tax on both parts and the capital purchase. An exemption certificate should always be submitted unless the vendor has a blanket certificate on file.

Some attachments to farm machinery or farm implements are tax exempt both with the original purchase and when replaced. These include hydraulic systems, weights, hitches, dual wheels, and other items necessary to the operation of the machine or implement. Also considered tax exempt are repair and replacement parts for tractors and implements which include batteries, tires, belts, mufflers, spark plugs, miscellaneous motor repairs, plow points, cutting parts, bolts and springs. There are other items that are tax exempt only if they are incorporated into the construction renovation or repair of on farm grain or soybean facilities or on farm chicken raising or livestock raising facilities. These include items which are incorporated into real property such as stalls, stanchions, drainage tile, fencing materials, and building materials.

Building materials incorporated into the construction, renovation or repair of On-Farm Grain or Soybean Facilities and On-Farm Chicken Raising Facilities are exempt from sales tax. Property to be incorporated into or used for on-farm grain or soybean facilities can be purchased tax-exempt with the farmer requesting a Certificate of Exemption for On-farm Grain or Soybean Facilities, Revenue Form 51A148-S1 from the retailer. This includes only those On-Farm Grain or Soybean Facilities used **exclusively** for grain or soybean storage, drying, processing or handling. In addition, property to be incorporated into or used for on-farm production or livestock which will ordinarily be considered food for human consumption can be purchased tax exempt with the farmer issuing the retailer a Certificate of Exemption for On-Farm Chicken or Livestock Raising Facilities, Revenue Form 51A153. This includes only those on-farm facilities used for poultry or livestock production.

Non-Exempt Farm Input Items (subject to tax)

There are several categories of items which are excluded from the category of farm machinery, and therefore, are subject to sales and use tax. These are containers and storage facilities such as milk cans, wash tanks, watering tanks, egg baskets, nonmechanical silos, nonmechanical feeders, and oil and gas storage tanks. Hand tools and wholly hand-operated equipment such as wheelbarrows, hoes, rakes, pitchforks, shovels, brooms, wrenches, pliers and grease guns are subject to tax. Miscellaneous farm equipment and supplies such as tobacco sticks and canvas, milk strainers, lawn and garden equipment, oils, greases and coke are non exempt. Attachments or accessories not essential to the operation of a machine (except when sold as part of an assembled unit) are non-exempt and therefore taxable. These include radios, canopies, air conditioning, cabs, deluxe seats, tool and utility boxes, and lubricators. Purchases from out-of-state retailers of items such as magazine subscriptions, oils and greases, hand tools, veterinary supplies, livestock medications, etc. are subject to *use tax*. If a farmer purchases an item from a Kentucky retailer,

and issues an exemption certificate, and then makes use of the property other than in an exempt manner, the farmer must report the purchase as subject to sales and use tax.

Non-exempt farming practices include feeding, boarding, training, etc. of horses, and the raising of rabbits, llamas and catfish. This means that sales tax must be paid on property purchased for use in the feeding, boarding, training, production, etc. of these enterprises. However, if catfish are produced for sale as human food, their production costs are exempt from the sales and use tax provisions. The retailer making sales of tangible personal property (feed, supplies, livestock, etc.) to non-exempt farmers is responsible for the sales and use tax unless an exemption is established. An exemption can be established by an exempt farmer by providing the retailer with an Agricultural Exemption Certificate, Revenue Form 51A106.

ISSUES AND ANSWERS

Issue #1: Sales and Use Tax Permit Requirements

Rita is a farmer in Kentucky. She produces grain crops and hogs on her farm. Rita only sells her products to the local grain elevators, the local cooperative and the slaughter house. All products that Rita produces are used as food items or are used for the production of food items.

Question 1A -- Is Rita required to obtain a Sales and Use Tax Permit?

Answer 1A -- It depends. All farmers making retail sales of tangible personal property are required by law to hold a sales and use tax permit. However, as a practical matter, the Revenue Cabinet only requires farmers making taxable retail sales to register and obtain a sales and use tax permit. A sales and use tax permit is not required for a farmer to issue a Farm Machinery Exemption Certificate, Agriculture Certificate of Exemption or a Certificate of Exemption for On-Farm Chicken or Livestock Raising Facilities. Consequently in Rita's situation

she is not required to have a Sales and Use Tax Permit because she sells to the local cooperative, grain elevators and the slaughter house.

Question 1B -- Assume the same situation but that Rita also produces some vegetables that she markets through a roadside stand. The vegetables are all food products and are sold directly to the consumer. Does the roadside activity require Rita to obtain a Sales and Use Tax permit?

Answer 1B -- No, food for human consumption is not taxed. Even though Rita now sells food directly to the consumer, there is no sales tax on human food.

Issue #2: Casual Sales of Taxable Products

Assume that Rita has the above same situations and that in addition she now added some additional enterprises to the normal farm products and produce that she now also produces:

- a. *Hay and straw which she bales into 50 lb. square bales.*
- b. *Vegetables which are used for decorative purposes and are considered non-edible.*
- c. *Chickens which are considered fighting cocks.*

Question 2A -- Is Rita now required to obtain a Sales and Use Tax Permit?

Answer 2A -- Yes, for some of the products she now sells, she is required to remit sales tax and pass it to the Kentucky Revenue Cabinet. Rita may have to file her sales tax form monthly, quarterly, annually or whenever she has a certain amount collected which is due to be paid. The Kentucky Revenue Cabinet will determine, upon reviewing the Sales and Use Tax Permit application, which method she will use to pay her sales and use tax obligations.

Hay which is *not* intended for the use of feeding livestock for the production of food purposes is considered a taxable item. Hay sold for the purposes of feeding horses or llamas is taxable. Hay sold to someone wishing to make a backstop for archery in their backyard should be charged sales tax.

Straw sales are always taxable to every purchaser except someone purchasing it for resale. In that case the purchaser should provide Rita a resale certificate in order to properly remove the burden of sales tax from Rita.

Vegetables not used for food consumption are taxable.

Chickens raised for non-food purposes are taxable.

In summary, under the conditions of the sales and use tax law, the seller is responsible for the tax unless it can be demonstrated that a resale certificate or an exemption certificate has been accepted in good faith from the purchaser.

1. The "good faith" requirement for exemption certificates (agricultural, purchase exempt, and farm machinery) requires the seller to obtain the appropriate certificate and maintain it on file. The purchaser must be in an activity which would entitle him/her to issue the specific type of exemption certificate.
2. "Good faith" on the part of the seller shall be demonstrated if the seller accepts a properly completed resale certificate, maintains it on file and determines that the property being sold to the purchaser is normally offered for resale in the type business operated by the purchaser.

Question 2B -- Rita's business from her roadside stand expands and she sells a large portion of her products as non-food items. Should Rita obtain a Sales and Use Tax Permit and how often will she have to file her sales and use tax payments?

Answer 2B -- Rita should obtain a Sales and Use Tax permit because some of her sales are considered non-food items and she is not selling her products for resale, but directly to the consumer.

Issue #3 Out of State Purchases

Rita's business in the non-food items at her roadside stand expands so she now starts to purchase some of her products from Sam, an out-of-state producer. She purchases decorative gourds, Indian corn used for decorative purposes and some special containers which she uses at her stand to display the specialty gourds.

Question 3A -- How should Rita handle her out-of-state purchases of gourds and Indian corn?

Answer 3A -- Rita intends to resell the gourds and Indian corn and therefore should provide the out-of-state seller a resale certificate, Resale Certificate Revenue Form 51A105. Rita will not pay sales tax to an out-of-state vendor if the vendor ships the product to her. If Rita picks up the merchandise out-of-state she should supply the vendor with a resale certificate in order to avoid paying sales tax to another state.

Question 3B -- How should Rita handle her out-of-state purchase of containers that she will use in her business?

Answer 3B -- Rita owes use tax on the purchases of the containers. She is going to use them in her business of the roadside stand and therefore they are considered taxable. Rita will file and pay use tax, Line 23, Form 51A102, on the purchase of the containers purchased out-of-state. If Rita had purchased the containers in Kentucky she should be charged sales tax by the seller and therefore would not have to report the purchase of the containers on the Sales and Use Tax Form (51A102).

Issue #4 Sales Outside Kentucky

Jerry is a Kentucky farmer who produces grain, beef, horses, cuts firewood, and makes specialty corn cob pipes. The pipes that he produces are a by-product of his corn production. He markets his grain, beef, horses and corn cob pipes nation wide. Jerry has a Sales and Use Tax permit.

Question 4A -- How does Jerry handle his sales of grain and beef when he sells to someone outside the state of Kentucky?

Answer 4A -- Sales of grain and beef are considered tax exempt in Kentucky if they are food products or feed used for the production of livestock held for the production of food. Because they are not considered taxable items in Kentucky, there is no sales or use tax due on these items even if they are sold outside the state. Goods sold out-of-state should be listed on Line 7 of Form 51A102. These goods will not be subject to Kentucky sales and use tax.

Question 4B -- How does Jerry handle the sales of horses that he sells in the state of Kentucky?

Answer 4B -- He charges, collects and remits sales tax to the Kentucky Revenue Cabinet on the sale of horses sold in Kentucky. However, horses sold for breeding purposes are exempt from sales or use tax.

Question 4C -- How does Jerry handle the sales of horses (not purchased for breeding purposes) that he sells outside the state of Kentucky? Does it make a difference if Jerry delivers the horses to the out of state buyer?

Answer 4C -- If the purchaser picks up or arranges to pick up the horses from Jerry's farm in Kentucky, Jerry will have to charge sales tax. It is considered a sale in Kentucky. If Jerry delivers the horses to the buyer outside the state's boundary, the sale is considered interstate commerce. Jerry reports the sale on Line 1 of the reporting Form 51A102 and then added to Line 7, Form 51 A102 because it is a sale in interstate commerce.

Question 4D -- How does Jerry handle the sale of corncob pipes that he sells in the state of Kentucky?

Answer 4D -- He charges, collects and remits sales tax to the Kentucky Revenue Cabinet on the sale of his corn cob pipes sold in Kentucky. A buyer of Jerry's corncob pipes may issue Jerry a resale certificate (51A105) if the buyer intends to resell them in their trade or business. In this case Jerry accepts the resale agreement and keeps it in his files at least 4 years.

Question 4E -- How does Jerry handle the sales of corncob pipes that he sells outside the state of

Kentucky? Does it make a difference if Jerry delivers the corncob pipes to the out of state buyer?

Answer 4E -- If the purchaser picks up or arranges to pick up the pipes from Jerry in Kentucky, Jerry will have to charge sales tax unless the buyer provides Jerry with a resale agreement. It is considered a sale in Kentucky. If Jerry sends the pipes to the buyer outside the state's boundary, the sale is considered interstate commerce. The sale is exempt from sales and use tax. Jerry reports the sale in gross receipts on the reporting form (51A102) and then deducts it on Line 7, 51 A102, because it is interstate commerce.

Question 4F -- Jerry sells firewood to residents of a nearby subdivision and sometimes to farmers who use it to heat tobacco stripping rooms. Should he charge sales tax on the sales of firewood?

Answer 4F -- Firewood sold for residential heating is not subject to sales tax. However, firewood sold for heating purposes other than residential is taxable. The following are examples of taxable uses of firewood:

- heating tobacco stripping rooms
- heating business areas.

Issue #5 Purchase of Farm Machinery

Linda is a farmer in Kentucky. She produces grain crops and llamas on her farm. Linda purchases a new tractor for \$50,000 from a Kentucky farm machinery dealer. The tractor will be used on her farm for the production of crops.

Question 5A -- Will Linda have to pay sales tax on the tractor?

Answer 5A -- No. Linda can provide the machinery dealer with a Farm Machinery Exemption Certificate 51A148. Linda declares, on this form, that the tractor will be used exclusively and directly in the occupation of tilling the soil for the production of crops, or in the occupation of raising and feeding livestock or poultry or for producing milk for sale.

Question 5B -- Will Linda have to pay sales tax on the tractor if she buys it from a farm machinery dealer in Tennessee?

Answer 5B -- No. The same circumstances apply. Linda provides the dealer with the Farm Machinery Exemption Certificate.

Question 5C -- What is Linda's obligation to pay sales tax on her tractor if she purchases it from Harry, the farmer just down the road from her?

Answer 5C -- Same situation. Linda provides Harry with the Farm Machinery Exception Certificate.

Question 5D -- Linda needs to purchase an incubator for her baby llamas. She can purchase one from a dealer in Quito, Ecuador. She orders it and receives delivery of it to her farm. What are Linda's tax obligations on the llama incubator?

Answer 5D -- The production of llamas is similar to that of horses. They are not considered livestock. Therefore inputs required for their production are taxable. In this case Linda will have to pay use tax on the incubator.

Question 5E -- What if Linda purchased the incubator from Steve a farm machinery dealer in Paducah, KY?

Answer 5E -- Linda is required to pay sales tax on the incubator.

Issue #6 Exemption of Agricultural Inputs

Mike is a next door neighbor to Linda the farmer discussed in Issue 5. Mike, like Linda, produces grain crops and he also produces beef for breeding and slaughter purposes. Mike has watched Linda's llama herd grow and expand and is interested in getting into the llama production business.

Question 6A -- Mike purchases seed, fuel, fertilizer, feed, etc. for his farming operation from SpendLess Farm Coop. What are his obligation on these agricultural inputs with respect to sales tax?

Answer 6A -- Mike can provide SpendLess Farm Coop with an Agricultural Exemption Certificate 51A106. This certificate specifies that seed, fertilizer,

feed (used for the production of livestock intended to become food for human consumption), farm chemicals, repair and replacement parts for farm machinery (does not include autos, trucks, trailers and truck-trailer combinations) can be exempt. The certificate also specifies that nonreturnable containers, livestock, and gasoline and fuel used to operate machines for agricultural purposes can also be exempt. Mike can provide this certificate for a single purchase item or he can mark that the certificate is a blanket certificate which will cover all his tax exempt purchases of the above listed input items.

Question 6B -- What are the consequences of Mike getting into the llama production business?

Answer 6B -- The production of llamas is not considered a farming enterprise for the production of food for human consumption. They are considered the same as horses. Mike will have to have a Sales and Use Tax Permit. Every sale of llamas will be subject to sales tax if sold in the state of Kentucky and Mike will be charged sales tax on the purchases of supplies etc. for the production of llamas.

Question 6C -- Mike will purchase feed for his llamas at the local feed store. Is the feed Mike purchases for his llamas subject to sales tax?

Answer 6C -- Yes, llamas are not produced for food and therefore are not eligible for an exemption for sales tax for their production. They are considered the same as horses. Mike will have to pay sales tax on any hay, straw and feed used in llama production.

IN SUMMARY

The subject of sales and use tax is a complex one. It can indeed be very costly to make a mistake and not charge, collect and remit sales in a timely manner. Imposed penalties and interest costs can make a mistake a costly one. A good rule of thumb is that if there is a doubt about the exemption of a farm product, farm machinery or real property, it is always a safe bet to call and ask the Kentucky Revenue Cabinet. The following list of Kentucky Taxpayer Service Centers and their phone numbers:

Taxpayer Service Center	Phone Number
Ashland	(606) 329-9982
Louisville	(502) 595-4512
Bowling Green	(502) 843-5470
Northern Kentucky	(606) 292-6603
Corbin	(606) 528-3322
Hazard	(606) 439-2388
Owensboro	(502) 686-3301
Hopkinsville	(502) 887-2521
Paducah	(502) 444-8148
Lexington	(606) 233-3837
Pikeville	(606) 437-4075

The Sales and Use Tax Section of the Kentucky Revenue Cabinet in Frankfort can be reached by calling (502) 564-4580. Farmers can apply for a sales and use tax number by completing Forms 10A101 and 10A100 . These and other forms can be ordered by calling one of the above phone numbers.

Tax Forms Mentioned in this Document

Form Number	Form Description
51A102	Sales and Tax Use Return
10A101	Kentucky General Business License Application
10A100	Kentucky Tax Registration Application for Withholding Corporation, Coal, Sales and Use Taxes
51A105	Resale Certificate
51A106	Agricultural Exemption Certificate
51A153	Certificate of Exemption for On-farm Chicken or Livestock Raising Facilities
51A148	Farm Machinery Exemption Certificate
51A148-S1	Certificate of Exemption for On-farm Grain or 24 Soybean Facilities