

Sales Tax Exemption Has Limits

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The information contained herein is believed to be correct. However, the opinions described cannot be construed to constitute statements binding upon the Tennessee Department of Revenue or The University of Tennessee.

Most Tennessee farmers and nursery operators are familiar with the state laws that exempt some agricultural sales from sales tax. The exemption generally states that proceeds from the sale of livestock, poultry, nursery stock, fruits, vegetables or other farm products produced by the farmer or nursery operator are exempt from sales tax. The exemption also applies in some instances to “like products” that are purchased for resale by the farmer. If at least 50 percent of the total sales of “like products” are from farm/nursery-produced products, then 100 percent of the sales (including products bought for resale) are tax-exempt. However, if less than 50 percent of sales of “like products” are from farm-produced products, then only the farm-produced products are tax-exempt. For example, if more than 50 percent of a farmer’s sales are from farm-raised tomatoes and the balance is from the sale of cucumbers, squash and sweet potatoes that were purchased off the farm for resale, the exemption applies to 100 percent of the sales because all of the produce (tomatoes, cucumbers, squash, and sweet potatoes) are considered “like products.” However, if more than 50 percent of a farmer’s sales are from farm-raised tomatoes and the balance is from the sale of “not-like products” such as jams and jellies that were purchased for resale the exemption does not apply to the jams and jellies.

This sales tax-exempt status has been understood in produce, livestock, nursery and commodity enterprises. However there is a degree of uncertainty regarding the applicability of the sales-tax exemption to farm-based, value-added retailing enterprises. During the summer of 2001, officials with the Tennessee Department of Revenue examined the tax-exemption policies and considered the applicability of these policies to farm-based retail markets for value-added farm products. Their examination centered around the determination of when a farm product ceases to be exempt from sales tax because fabrication/processing has occurred and changed the product from its natural state at the time of harvest. Examples include jams and jellies made from fruits grown by the farmer and hams, bacon and sausage made from farm-raised hogs.

Tennessee Department of Revenue officials concluded that the “fifty-percent test” should be applied to value-added products. Therefore, if further fabrication or processing (value-added) by a farmer/producer creates a product consisting of, in content (where content is normally evaluated by weight) greater than 50 percent of the farmer’s self-produced product, then the sale of the product is exempt from state sales tax. In this case, if the result of the additional processing were exempt, the farmer would pay tax to the supplier of these inputs when they are purchased. However, if the final product is taxable, the farmer must be registered with the Tennessee Department of Revenue for the purpose of sales tax collection. If the product is taxable, the farmer should use a re-sale certificate to acquire the non farm-produced products necessary for the production process. The re-sale certificate enables the farmer to avoid paying sales tax on the non-farm produced inputs.

When the 50-percent-of-sales test is met, at least two general areas apply to consideration of the sales-tax exemption to value-added farm products. First, the “like products” rule described earlier still applies. Second, production and sales must be from the same legal entity. If the farm is a sole proprietorship then that same sole proprietorship must make the sales which claim the exemption. Conversely, if the farm is a sole proprietorship and a separate business organization is responsible for the retail sales, the exemption does not apply (even if the farmer is the only stock holder in the separate business, the same legal entity does not control both production and sales and the exemption cannot be claimed).

If a farmer adds value to farm-grown tomatoes by producing salsa and more than 50 percent of sales are from the farm-produced products, then additional “like-products” that are purchased for resale may fall under the sales-tax exemption. If, however, more than 50 percent of sales are from farm-produced vegetables and the balance of sales are from grocery items and an on-farm sandwich shop, only the farm-produced items are sales tax exempt because the grocery items and sandwiches are not “like products.” Other example scenarios are described below.

<u>EXAMPLES</u>	
<u>EXEMPT</u>	<u>NON EXEMPT</u>
A strawberry grower produces strawberry preserves. Each jar of preserves contains (by weight) 60% strawberries, 30% sugar, and 10% pectin. Each jar of strawberry preserves can be sold tax exempt.	A strawberry grower produces strawberry preserves. Each jar of preserves contains (by weight) 40% strawberries, 30% sugar, 20% preservatives and 10% pectin. The strawberry preserves cannot be sold tax exempt.
The same producer above also sells jams and jellies that were made off the farm by another supplier. As long as more than 50% of the total jams and jelly sales are from the farm-derived strawberry preserves, all of the jams and jellies can be sold tax exempt.	A strawberry grower produces strawberry preserves. Each jar of preserves contains (by weight) 60% strawberries, 30% sugar, and 10% pectin. Each jar of strawberry preserves can be sold tax exempt. However, if the farm-derived preserves account for less than 50% of total preserve-like products, the purchased for re-sale products cannot be sold tax-exempt.
A tomato, pepper and onion grower produces salsa where each jar of salsa contains (by weight) 40% farm-grown tomatoes, 20% farm-grown peppers, 20% farm-grown onions and 20% other ingredients. Each jar of salsa can be sold tax exempt.	A tomato, pepper and onion grower produces salsa where each jar of salsa contains (by weight) 40% farm-grown tomatoes, 20% farm-grown peppers, 20% farm-grown onions and 20% other ingredients. Each jar of salsa can be sold tax exempt. However, if the farm-derived salsa accounts for less than 50% of total salsa-like products, the purchased for re-sale products cannot be sold tax exempt.

Many of these situations and scenarios will fall into the “gray area” of the sales-tax exemption law and will require examination and application by the Tennessee Department of Revenue on a case-by-case basis. This will often require evaluation on an individual, case-by-case basis. The Tennessee Department of Revenue may be contacted at (615) 253-0600, or toll free in-state at 1-800-342-1003 or on-line at <http://www.state.tn.us/revenue/>. Additional information regarding contacting the Tennessee Department of Revenue is available in ADC Info #60.

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