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BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund	)	D E T E R M I N A T I O N
	)	
	)	No. 21-0061
	)	
. . .	)	Registration No. . . .
	)	

[1] RCW 82.04.625: EXCISE TAXES – BUSINESS AND OCCUPATION TAX – EXEMPTIONS. A Washington farmer that performed harvesting and cultivation services for its customers qualifies for the custom farming services exemption.

[2] WAC 458-20-210; RCW 82.12.855: EXCISE TAXES – USE TAX – EXEMPTIONS. A Washington farmer that purchased and used farm machinery and equipment in performance of its custom farming services is not eligible for a use tax exemption because its use was not limited to replacement parts for qualifying farm machinery and equipment.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

McCormick, T.R.O. – A farmer disputes the Department's assessment of business and occupation tax on the harvesting and cultivation services it provided, claiming that its services are exempt from the tax as custom farming services. The farmer also disputes the Department's assessment of use tax on its purchases of equipment . . . that it used in performing its services. The petition is granted in part, and denied in part.[1]

ISSUES

1. Whether the harvesting and cultivation services provided by a farmer are exempt from the business and occupation tax under RCW 82.04.625, as custom farming services.

2. Whether a farmer's purchases of equipment . . . it used in performing harvesting and cultivation activities are exempt from use tax under RCW 82.12.855 and WAC 458-20-210.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDINGS OF FACT

. . . (Taxpayer), provides services for farmers in the . . . region. The majority of the company's work consists of harvesting activities, such as baling hay, and crop cultivation services. A small portion of the revenue Taxpayer receives is from vehicle and machinery repair, as well as hauling services.

In 2019, the Department's Audit Division (Audit) reviewed Taxpayer's business activities for the period of January 1, 2015, through September 30, 2018. During the course of the review, Audit discovered that Taxpayer had mistakenly reported its tax liabilities during the covered periods under the wholesaling business and occupation (B&O) tax classification. Audit determined that Taxpayer primarily engaged in performing horticultural services for farmers on their own lands, including baling hay, corn planting, grass chopping, corn chopping, and plowing. Audit further determined that Taxpayer also performed some vehicle and machinery repair work and hauling services. Audit reclassified the income that was previously reported by Taxpayer as wholesaling to the service and other activities B&O tax classification, credited Taxpayer for amounts it previously paid under the incorrect tax classification, and assessed Taxpayer for the difference. Audit further assessed use tax on Taxpayer's purchases of equipment . . . it used in performing its services, where Taxpayer did not previously pay retail sales tax.[2]

On March 28, 2019, the Department issued Letter ID . . . , a notice of balance due (Assessment), in the amount of $. . . , which includes $. . . in service and other activities B&O tax, $. . . in use tax, a five percent substantial underpayment penalty in the amount of $. . . , a nine percent delinquent penalty in the amount of $. . . for the June 2017 period, $. . . in interest, and credits Taxpayer for amounts previously paid under the incorrect tax classification. . . .

On April 23, 2019, Taxpayer timely petitioned for administrative review of the Assessment. Taxpayer asserts that its harvesting and cultivating activities qualify for exemption from B&O tax as custom farming services. Taxpayer does not dispute Audit's determination that its business activities were horticultural services or Audit's reclassification of the income to the service and other activities B&O tax classification.

Taxpayer asserts that it is primarily engaged in providing custom farming services for other farmers on the other farmers' own lands. . . . Taxpayer further asserts that pursuant to [its] agreements, it performs the agreed upon services and subsequently bills its customers. On appeal, Taxpayer provided letters from three of Taxpayer's customers, each of which contains the following statement: "That. . . [Taxpayer] was under the direct supervision or at the direction of . . . [one of Taxpayer's owners]," and affirmed by the signature of the customer. Taxpayer claims that the three customers' combined accounts paid 80 percent of the revenue received by Taxpayer during the audit period. Taxpayer submitted a customer listing showing the revenue it received during the audit period and the percentage of total revenue received from each customer in support of its claim.

[2] Audit assessed use tax on Taxpayer's purchases of equipment, including an inoculant applicator, a bale wrapper, a trash pump, a . . . agricultural telehandler, a generator, and a . . . Backhoe. . . .

Taxpayer also asserts that it qualifies for the custom farming services exemption because one of its owners, . . . (Owner), is an eligible farmer that owns at least 50 percent of Taxpayer. In support of this assertion, Taxpayer submitted copies of its tax returns as evidence that Owner owns a 50 percent interest in the company. Taxpayer also submitted copies of relevant portions of Owner's individual annual tax returns for the years 2015 through 2018.

Additionally, Taxpayer asserts that because Owner is an eligible farmer, it is an eligible farmer performing custom farming services, and therefore its purchases of equipment . . . that it used in performing its services are exempt from use tax. Taxpayer contends that its specific purchases of the bale wrapper, agricultural telehandler, and backhoe should further be exempt from use tax as farm machinery. Taxpayer concedes that a portion of the revenue it received came from performing vehicle and machinery repairs and hauling services, and not from custom farming services. Taxpayer does not dispute Audit's assessment of tax liability pertaining to these services.

In response to Taxpayer's petition, Audit asserts that Taxpayer does not qualify for the exemption because Taxpayer has failed to establish that it performed its services either under a contract with farmers or under the direction or supervision of farmers. Audit requests "that the Taxpayer provide records to show that the work performed was under contract or under the direct supervision of a farmer." Division Response at 3. Audit does not dispute that Taxpayer operated under verbal agreements with its customers.

ANALYSIS

1. Taxpayer's harvesting and cultivation activities qualify for the custom farming services exemption.

Washington imposes B&O tax on every person with a substantial nexus with this state for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax is measured by applying particular rates against the value of products, gross proceeds of sales, or gross income of the business, as the case may be. RCW 82.04.220.

Persons performing horticultural services are generally subject to the service and other activities B&O tax. RCW 82.04.290. Horticultural services include crop cultivation services, such as planting, and crop harvesting services, such as mowing and baling hay. WAC 458-20-209(2)(c)(i)(B)-(C).

WAC 458-20-209(3) provides:

> (a) A farmer who *occasionally assists another farmer* in planting or harvesting a crop is generally not considered to be engaged in the business of performing horticultural services. These activities are generally considered to be casual and incidental to the farming activity . . . .
> (b) The extent to which horticultural services are performed for others is determinative of whether or not they are considered taxable business activities. Persons who advertise or hold themselves out to the public as being available to perform farming for hire will be considered as being engaged in business. For

> example, *a person who regularly engages in baling hay or threshing grain for others is engaged in business and taxable upon the gross proceeds derived therefrom*, irrespective of the amount of such business or that this person also does some farming of his or her own land.

(Emphasis added.)

Here, Taxpayer regularly engages in baling hay, corn planting, grass chopping, corn chopping, and plowing for other farmers. Each of the services provided by Taxpayer constitutes either crop cultivation services or crop harvesting services, and thus, horticultural services that are generally subject to B&O tax. However, Taxpayer asserts that these services are exempt from B&O tax.

The Washington State Legislature has enacted a number of exemptions to B&O tax. These exemptions are not presumed, but instead the taxpayer claiming the exemption must clearly establish that it is entitled to the exemption. *Group Health Co-op v. Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201, 205 (1967). Taxpayer bears the burden to clearly establish that it is entitled to the exemption.

RCW 82.04.625 establishes [an exemption] for custom farming services, and provides:

> (1) This chapter does not apply to any:
> (a) Person performing custom farming services for a farmer, when the person performing the custom farming services is: (i) An eligible farmer; or (ii) at least fifty percent owned by an eligible farmer; . .
> (2) The definitions in this subsection apply throughout this section.
> (a)(i) "Custom farming services" means the performance of specific farming operations through the use of any farm machinery or equipment, farm implement, or draft animal, together with an operator, when: (i) [(A)] The specific farming operation consists of activities directly related to the growing, raising, or producing of any agricultural product to be sold or consumed by a farmer; and (ii) [(B)] *the performance of the specific farming operation is for, and under a contract with, or the direction or supervision of, a farmer.*
> (ii) For the purposes of this subsection (2)(a), "specific farming operation" includes specific planting, *cultivating, or harvesting activities*, or similar specific farming operations…
> (b) "Eligible farmer" means a person who is eligible for an exemption certificate under RCW 82.08.855 at the time that the custom farming services are rendered, regardless of whether the person has applied for an exemption certificate under RCW 82.08.855.

(Emphasis added.)[3]

[3] [RCW 82.04.625 no longer exists, having expired as of December 31, 2020.]

Pursuant to RCW 82.08.855, an eligible farmer is generally a person who meets the definition of farmer under RCW 82.04.213,[4] and whose gross sales or harvested value of agricultural products grown, raised, or produced by that person were at least ten thousand dollars. RCW 82.08.855(4)(b)(i)-(v).

The reference to a "farmer" in RCW 82.04.625 is distinct from the reference to an "eligible farmer," and it establishes another requirement to qualify for the custom farming exemption. First, the person performing "custom farming services" must be an "eligible farmer" or an "eligible farmer" must own a majority stake in the entity that performs, the custom farming services. RCW 82.04.625(1)(a). Second, in order to constitute "custom farming services," the performance of the specific farming operation must be: (a) for a "farmer"; and (b) under a contract with or the direction or supervision, of a "farmer." RCW 82.04.625(2)(a)(i). As explained above, "farmer" is defined in RCW 82.04.213.

Here, Taxpayer and Audit agree that Taxpayer is an entity where an "eligible farmer" (Owner) owns a majority stake. In dispute is whether Taxpayer's activities constitute "custom farming services" under RCW 82.04.625(2)(a). There is no dispute that Taxpayer provides its services for farmers or that such services constitute the specific farming operations eligible to be "custom farming services." The sole issue regarding qualification for the exemption is whether the services provided to farmers were either under a contract with the farmers or done under the direction or supervision of the farmers.

We first note that the language at issue from RCW 82.04.625(2)(a)(i), which provides that the work provided to farmers must be done "under a contract with, or the direction or supervision of, a farmer[,]" does not limit the exemption to situations where the work is done under a written agreement. The plain language of this statute allows for both formal and informal arrangements with farmers. In Washington, it is well established that . . . [contracts need not be written]:

> A contract may be oral. *Hankins v. American Pac. Sales Corp.*, 7 Wn. App. 316, 499 P.2d 214 (1972). A contract may be implied in fact with its existence depending on some act or conduct of the party sought to be charged. It may arise by inference or implication from circumstances which, according to the ordinary course of dealing and the common understanding of men, show a mutual intention on the part of the parties to contract with each other. *Ross v. Raymer*, 32 Wn.2d 128, 201 P.2d 129 (1948).

Bell v. Hegewald, 95 Wn.2d 686, 690, 628 P.2d 1305, 1306–07 (1981). Thus, in order to determine whether a verbal agreement between two parties constitutes a contract, we must consider the acts or conduct of the parties involved and the underlying circumstances as to whether they evidence a mutual intention on the part of the parties to contract with each other.

[4] Under RCW 82.04.213(2)(a), "Farmer" means any person engaged in the business of growing, raising, or producing, upon the person's own lands or upon the lands in which the person has a present right of possession, any agricultural product to be sold, and the growing, raising, or producing honeybee products for sale, or providing bee pollination services, by an eligible apiarist.

Here, it is undisputed that Taxpayer provided its services to farmers pursuant to verbal agreements. The fact that these agreements were oral and not written does not preclude us from determining that Taxpayer performed its services under contract with its customer farmers.

It is further undisputed that, pursuant to these agreements, Taxpayer performed its services for the farmers and was subsequently paid for these services by them. The audit report provided additional details regarding each of the subject transactions. Taxpayer also provided letters from three of its customers as further evidence of the oral agreement that governed the terms of the specific farming operations provided to farmers.

After considering the conduct of Taxpayer and its customer farmers, the underlying circumstances, the audit report, and Taxpayer's letters, we determine that there is sufficient evidence of a mutual intention to enter into an agreement between Taxpayer and its farmer customers for the performance of such specific farming operations, and these services constitute custom farming services under RCW 82.04.625. Thus, Taxpayer is an eligible farmer who performed custom farming services for farmers, and is eligible for the custom farming services exemption from B&O tax. Accordingly, we grant the petition as to this issue.

2. Taxpayer's purchases of equipment . . . that it used in performing its services are properly subject to use tax.

In Washington, all sales of tangible personal property to consumers are subject to retail sales tax unless the sales are otherwise exempt from taxation. RCW 82.08.020; RCW 82.04.050. Use tax complements retail sales tax by imposing a tax of like amount upon the privilege of using within this state as a consumer any article of tangible personal property acquired without payment of retail sales tax. *See* RCW 82.12.020(1), (2). The term "use" is statutorily defined and means:

> With respect to tangible personal property, . . . the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include[s] installation, storage, withdrawal from storage, distribution, or any other act preparatory to subsequent actual use or consumption within this state[.]

RCW 82.12.010(6)(a); WAC 458-20-178(3). Thus, when a taxpayer purchases tangible personal property without paying retail sales tax, and then actually uses or consumes the tangible personal property as a consumer, it is subject to use tax on its use of the subject purchases.

Here, the subject equipment . . . purchased by Taxpayer were tangible personal property. Taxpayer did not pay retail sales tax on these items when it purchased them. Taxpayer's purchases of equipment include a bale wrapper, agricultural telehandler, and backhoe. Each of these were actually used by Taxpayer as a consumer when it performed specific farming operations, including baling hay, corn planting, grass chopping, corn chopping, and plowing. . . . Because Taxpayer did not pay retail sales tax when it purchased each of the subject items of tangible personal property, and actually used or consumed each of the subject items as a consumer, its use of each item is properly subject to use tax.

The Washington State Legislature has enacted a number of exemptions to both retail sales tax and use tax, and these exemptions are not presumed, but instead the taxpayer claiming the exemption must clearly establish that it is entitled to the exemption. *Group Health Co-op v. Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201, 205 (1967). Here, Taxpayer disputes the Department's assessment of use tax, asserting that its purchases of the subject equipment . . . are exempt from retail sales tax because it is an eligible farmer and the equipment . . . [was] used in performing custom farming services. . . .

. . .

RCW 82.12.855 provides an exemption from use tax for the use by an eligible farmer of *replacement parts* for qualifying farm machinery and equipment. RCW 82.12.855(1)(a) (emphasis added). WAC 458-20-210 is the Department's corresponding administrative rule and echoes the statute. However, purchases of farm machinery and equipment used in farming remain subject to the retail sales tax and use tax. *See* WAC 458-20-210(7)(e); Special Notice: Repair Parts and/or Services for Farm Machinery and Equipment – Sales and Use Tax Exemptions Update (Special Notice) (June 3, 2014). The Special Notice provides, "The purchase or use of the following items and services remain subject to retail sales or use tax, unless some other exemption applies: *All machinery and equipment used in farming*, including farm vehicles and other motor vehicles, tractors, and other farm implements; . . ." (Emphasis added.)

Here, Taxpayer asserts that its use of a bale wrapper, agricultural telehandler, and backhoe, are farm machinery and equipment and should be exempt from use tax, but fails to cite any specific exemption that applies. RCW 82.12.855 specifically provides an exemption from use tax for the use of replacement parts only, but provides no such exemption for the use of any qualifying farm machinery and equipment. Thus, because Taxpayer's use of the subject equipment does not qualify for exemption under RCW 82.12.855 and Taxpayer has failed to establish that some other exemption applies, the Department correctly assessed use tax on Taxpayer's use of the farm machinery and equipment.

. . .

DECISION AND DISPOSITION

Taxpayer's petition is granted in part, and denied in part. We grant the petition with respect to the Department's assessment of service and other activities B&O tax because Taxpayer is eligible for the custom farming services exemption. We deny the petition as to the Department's assessment of use tax because Taxpayer has failed to establish that an exemption applies to its purchases of the subject equipment.

Dated this 15th day of March 2021.