Assembly Bill 1247 (Irwin)
Date: 03/24/15
Program: Sales and Use Tax
Sponsor: California Compost Coalition
Revenue and Taxation Code Section 6358
Effective: Upon enactment, but operative 1st day of 1st quarter 90 days after enactment

Michele Pielsticker (Chief) 916.322.2376
Debra Waltz (Analyst) 916.324.1890
Tom Trach (Revenue) 916.445.0840

Summary: Exempts from sales and use tax organic input material applied to land, the products of which are to be used as food for human consumption or are to be sold in the regular course of business.

Purpose: To promote the use of clean (organic) compost, mulch, and wood products and to increase the recycling of organic materials, which in turn will reduce organics in landfills, reduce GHG emissions, reduce water consumption, and reduce the use of petro-based chemicals (fertilizers) in agriculture and landscaping.

Fiscal Impact Summary: Annual state and local revenue loss of $1 million.

Existing Law: Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law[1] imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer.

Existing Revenue and Taxation Code (RTC) Section 6358 (d) provides an exemption from sales and use tax for the gross receipts from the sale and storage, use, or other consumption of fertilizer to be applied to land, the products of which are to be used as food for human consumption or are to be sold in the regular course of business.

For purposes of the exemption, BOE's Sales and Use Tax Regulation *Seeds, Plants, and Fertilizer* 1588(b)(1) defines the term "fertilizer," to include commercial fertilizers, agricultural minerals, manure, and carbon dioxide. The regulation defines the terms "commercial fertilizers" and "agricultural minerals" as defined in Food and Agricultural Code (FAC) Sections 14522 (commercial fertilizer) and 14512 (agricultural minerals). Regulation 1588 specifically provides that the term "fertilizer" does NOT include "packaged soil amendments" or "auxiliary soil and plant substances" as these terms are defined in FAC Sections 14522 (packaged soil amendments) and 14513 (auxiliary soil and plant substances).

In addition, Regulation 1588 (b)(2) specifically provides that tax does not apply to sales of fertilizer to be applied to land (including foliar application), provided the land is used to produce any of the following:

- Food for human consumption.
- Feed for food animals, which ordinarily constitute food for human consumption (includes pasture grasses).
- Products to be sold in the regular course of the purchaser's business (e.g., house plants, flowers, etc).

Under existing FAC 14550.5,[2] "organic input material" means any bulk or packaged commercial fertilizer, agricultural mineral, auxiliary soil and plant substance, specialty fertilizer, or soil amendment, excluding pesticides, that is to be used in organic crop and food production and that complies with the requirements of the National Organic Program standards, as specified in Part 205 (commencing with Section 205.1) of Subchapter M of Chapter I of Subtitle B of Title 7 of the Code of Federal Regulations.

[1] Part 1 of Division 2 of the Revenue and Taxation Code (RTC) (commencing with Section 6001).
[2] Assembly Bill 856 (Chapter 257, Statutes 2009, Caballero, effective January 1, 2010)

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Under Sales and Use Tax Regulation 1588, commercial fertilizers, agricultural minerals, and specialty fertilizers that are organic input materials are exempt from the sales and use tax. Auxiliary soil and plant substances and soil amendments, however, are NOT exempt.

Proposed Law: This bill amends RTC Section 6358 to provide a sales and use tax exemption for the sale and use of certain organic input material applied to land, the products of which are to be used as food for human consumption or are to be sold in the regular course of business.

The bill defines "organic input material" to mean auxiliary soil and plant substance, specialty fertilizer, or soil amendment, excluding pesticides, that complies with the requirements of the National Organic Program standards, as specified in Part 205 (commencing with Section 205.1) of Subchapter M of Chapter I of Subtitle B of Title 7 of the Code of Federal Regulations.

As a tax levy, the bill takes effect immediately, but becomes operative on the first day of the first calendar quarter commencing more than 90 days after enactment.

California Department of Food and Agriculture (CDFA): The CDFA's Feed, Fertilizer, Livestock Drugs Regulatory Services administers a fertilizing materials program to license individuals or companies that manufacture, produce, or distribute fertilizing materials sold or distributed in California. Any individual or company who manufactures, produces, or distributes fertilizing materials in California are required to obtain a Commercial Fertilizing Materials License for each plant and business location that they operate prior to engaging in the activity. A fertilizing materials license is valid for a two-year period. Fertilizing materials include commercial fertilizers, agricultural minerals, auxiliary soil and plant substances, packaged soil amendments, specialty fertilizers, and organic input materials.

In addition, before a fertilizing material may be sold or distributed in California, the product label must be approved and registered by the CDFA.[3]

All organic input materials require both licensing and registration. The CDFA's Fertilizing Materials Inspection Program registers fertilizing materials to be used in organic crop and food production. Organic input materials include commercial fertilizers, agricultural minerals, specialty fertilizers, auxiliary soil and plant substances, and soil amendments. The CDFA maintains a listing of all registered organic input materials on its website: www.cdfa.ca.gov/is/ffldrs/pdfs/RegisteredOrganicInputMaterial.pdf.

Commentary:

1. **Effect of the bill.** This bill exempts from sales and use tax the sales of certain organic input materials to be applied to land, provided the land is used to produce food products or products to be sold in the regular course of business. The bill defines "organic input material" as auxiliary soil and plant substances, specialty fertilizers,[4] and soil amendments that comply with the National Organic Program standards. Accordingly, based on BOE's Sales and Use Tax Regulation 1588, sales of non-organic auxiliary soil and plant substances and soil amendments would remain subject to tax.
2. **Identifying exempt organic input material products appears uncomplicated.** The CDFA's Organic Input Material Program registers and maintains a list of organic input materials on its website. The list includes the firm name and product, brand name, or trademark information.
3. **Sales and use tax exemption of fertilizer applies to organic and non-organic fertilizers.** As previously stated, Regulation 1588 defines the term "fertilizer" to include commercial fertilizers,

[3] Commercial fertilizers and bulk agricultural minerals that are sold for commercial use are exempt from registration. However, these entities are still required to comply with all labeling laws and regulations. Commercial usage includes agricultural production, golf course maintenance, and commercial landscaping. Commercial fertilizers sold for home and garden use are classified as specialty fertilizers and require registration.

[4] Specialty fertilizers are included in the definition of commercial fertilizers under FAC Section 14522. For sales tax NOT to apply, the specialty fertilizer must be used to produce (1) food for human consumption, products to be sold by the purchaser, and fee for food animals.

agricultural minerals, manure, and carbon dioxide. The terms commercial fertilizer and agricultural minerals are defined in the FAC and include both organic and non-organic substances. To qualify for the exemption, the fertilizer must be applied to land to produce food, feed for food animals (including pasture grasses), and products to be sold by the purchaser (e.g., flowers). Auxiliary soil and plant substances and soil amendments (organic and non-organic) are specifically excluded from the definition of fertilizer, and are thus subject to tax.

4. **Definition of organic input material.** Organic input material is defined in FAC Section 14550.5 (see page 1 of analysis). The bill's definition of organic input material is similar to Section 14550.5, with the exception that it does not include the terms "commercial fertilizer" or "agricultural mineral" and does not require that the organic input material is to be used in organic crop and food production. According to the author's office, the bill's definition does not include these terms because they are already exempt under current law. Additionally, the proposed exemption is intended to apply to organic input material used in both organic and non-organic crop and food production. To avoid confusion, BOE staff recommends using Section 14550.5 definition for organic input material, and including a provision to specify, notwithstanding Section 14550.5, organic input material may be used in non-organic farming. BOE staff will work with the author's office to address this concern.

5. **Certain sales of compost or mulch may qualify as an exempt fertilizer under Regulation 1588.** Compost or mulch that conforms to FAC Section 14512, *Agricultural Mineral*, and is considered an agricultural mineral by the CDFA, for which the seller is required to obtain Fertilizing Materials License before distributing the product in California, would qualify as an exempt fertilizer under Regulation 1588.

Administrative Costs: The BOE will incur absorbable administrative costs to notify affected retailers, audit claimed exemptions, amend appropriate regulations and publications, and answer inquiries from the general public and affected retailers.

Revenue Impact:

Background, Methodology, and Assumptions. According to the California Department of Food and Agriculture (CDFA), fertilizing materials sales in California amounted to an estimated $2.64 billion in FY 2013-14. Further, CDFA states that organic input material sales represent approximately 4.48% of total fertilizer sales in California. Accordingly, estimated sales of organic input material amounted to $118 million ($2.64 billion x 4.48% = $118 million).

CDFA also indicated that 90% of the $118 million in organic input material are already exempt from sales and use tax because it currently meets the definition of a fertilizer. The remaining 10% of organic input material, or $11.8 million, would be subject to this new exemption.

Using the estimated $11.8 million as a basis, staff estimates annual sales and use tax loss of $1 million ($11.8 million taxable organic input material x 8.42% statewide average rate = $1 million).

Revenue Summary. The proposed exemption would result in an estimated annual sales and use tax revenue loss of $1 million, as follows:

State (General Fund)	3.94%	$465,000
Education Protection Account	0.25%	$30,000
Fiscal Recovery Fund	0.25%	$30,000
Local Revenue Fund 2011	1.06%	$127,000
Local Revenue Fund 1991	0.50%	$60,000
Local Public Safety Fund	0.50%	$60,000
Bradley Burns	1.00%	$118,000
Special District	0.92%	$110,000
Statewide Average Rate	8.42%	$1,000,000

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.