Harvey Hilderbran
MEMBER
The Texas House of Representatives
State Representative • District 53

RQ-1113-GA

February 15, 2013

The Honorable Greg Abbott
Attorney General of Texas
209 W. 14th Street
Austin, Texas 78701

RE: Opinion on whether implements of husbandry used at a cattle feedlot qualify as equipment used in the "production of farm or ranch products" pursuant to Section 11.161 of the Texas Tax Code

Dear General Abbott:

It has come to my attention that cattle feedlot owners are encountering inconsistent property tax treatment in various counties throughout the state. Confusion appears to stem from (i) whether a cattle feedlot is engaged in the *production of farm or ranch products* and (ii) inapplicable authorities that predate the 1982 addition of Section 19a to Article VIII of the Texas Constitution and the enactment of Section 11.161 of the Texas Tax Code.

Legislative and Interpretive History

As I understand the legislative history, farm products in the hands of the producer have been exempt from ad valorem taxation since 1879, and livestock and poultry were expressly added to the exemption in 1981. Tex. Const. art. VIII, § 19.[1] In 1982, the Texas Constitution was amended to add a new Section 19a, which authorizes a property tax exemption on equipment or "implements of husbandry" used to produce farm products.

Article VIII, § 19a of the Texas Constitution states:

> "Sec. 19a. IMPLEMENTS OF HUSBANDRY; EXEMPTION. Implements of husbandry that are used *in the production* of farm or

[1] *See also* Tex. Tax Code Section 11.16.

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> ranch products are exempt from ad valorem taxation." (*Emphasis added.*)

In conjunction with the 1982 constitutional amendment, the 1981 Texas Legislature enacted Section 11.161 of the Texas Tax Code, which currently reads[2]:

> "Section 11.161. Implements of husbandry. Machinery and equipment items that are *used in the production of farm or ranch products*[3] or of timber, regardless of their primary design, are considered to be implements of husbandry and are exempt from ad valorem taxation." (*Emphasis added.*)

In 1982, shortly after the effective date of Section 11.161, the Attorney General issued Opinion MW-451, interpreting Section 11.161. At that time, Section 11.161 read "an individual is entitled to an exemption from taxation of implements of farming or ranching that he owns and uses in the production of farming and ranch products." MW-451 found (i) that items other than fixtures and improvements to real property may, depending on the facts, qualify as implements under the statute, (ii) that only natural persons, not entities, were entitled to the exemption, and (iii) that dollar limitations applied to the exemption. However, due to subsequent statutory amendments, legal entities may now qualify for the exemption and dollar limitations no longer apply.

In 1987, Attorney General Opinion JM-718 found that implements of husbandry are "items of equipment or machinery whose primary design and primary use or purpose is that of an implement used by a farmer or rancher in conducting his farming or ranching operations." JM-718 did not address whether feedlots were farming or ranching operations. Section 11.161 was amended subsequent to JM-718 to modify the prior "primary design or purpose" clause.

It is my understanding that no post-1982 ad valorem tax guidance explains whether feedlots engage in the production of farm or ranch products for purposes of Section 11.161 of the Texas Tax Code with enough clarity to cause uniform enforcement among counties.

Current Authorities

Section 11.161 of the Texas Tax Code has been amended four times since its effective date in 1982. Each amendment has clarified or broadened its meaning to avoid interpretations that were inconsistent with its meaning and the purpose of Article VIII, § 19a of the Texas Constitution. In its current version, it literally covers all machinery and equipment used by any individual or entity in the production of farm or ranch products, regardless of primary design.

Under the Texas Tax Code, the *production* of agricultural products frequently qualifies as an agricultural use, in contrast to the *processing* of agricultural products, which often does not qualify. *See* Texas Tax Code Sections 11.16, 11.161, and 23.51(2). In 1990, the Comptroller of

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[2] Section 11.161 was amended in 1983, 1991, 1999, and 2005.

[3] Section 11.16 of the Texas Tax Code, which immediately precedes section 11.161, expressly defines "farm products" to include "livestock."

Public Accounts adopted by rule its *Manual for the Appraisal of Agricultural Land*, (the "*Manual*") which discusses the distinction between production and processing in agriculture. The *Manual* provides, in pertinent part:

> "Processing begins with those steps typically carried out at the first level of trade beyond production. Storage or packaging for wholesale trade would constitute 'processing' as would *slaughtering* livestock. The producer's interim storage prior to sale to a wholesaler or other middleman would not. Goods in storage would be exempt as farm products in the hands of the producer, and land devoted to storing them would be eligible for agricultural valuation.
>
> Processing begins when primary agricultural products are broken into smaller parts or combined with other products. Grain, for example, is processed when it is milled. Milk is processed when it is separated into butter, milk, and other dairy products. Grapes are processed when they are washed, sorted, or crushed. Vegetables and fruits are processed when they are washed and packaged for sale at the wholesale or retail level.
>
> Processing begins when activities occur that enhance the value of the primary agricultural products. Milling grain, pasteurizing milk, and ginning cotton constitute processing. Packaging products for transport to market would not constitute processing, but packaging them for sale would."

The *Manual* supports the position that production ends and processing begins after the harvest of crops or the slaughter of livestock. Thus, feedlot operations, which only involve the feeding and keeping of *live* animals, should logically be considered production rather than processing.[4]

Likewise, Texas Tax Code Section 151.316(c) dealing with sales tax defines a "farm or ranch" as:

> "one or more tracts of land used, in whole or in part, in the production of crops, livestock, or other agricultural products held for sale in the regular course of business. ***The term includes feedlots, dairy farms, poultry farms, commercial orchards, commercial nurseries, and similar commercial agricultural operations.***"

The Texas Comptroller has treated feedlots as farms or ranches since 1974.[5] Subsequent Comptroller policy letters also support the proposition that feedlots are farms or ranches, and machinery and equipment used on feedlots are implements of husbandry exempt from sales tax.[6]

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[4] The *Manual* has been cited as having the "force and effect of law." *See Pizzitola v. Galveston County Central Appraisal District*, 808 S.W.2d 244 (Tex. App.-Houston [1st Dist.] 1991, *no writ*).

In 2010, pursuant to the Texas Comptroller's authority[7] to prescribe and approve property rendition forms and to provide technical assistance and information,[8] the Comptroller issued administrative guidance to the state's chief appraisers explaining that machinery and equipment used at a feedlot for the production of livestock held for sale in the regular course of business is exempt from property taxation and need not be rendered. However, the administrative guidance is not being uniformly followed by chief appraisers.

One point of confusion may stem from *Smith v. Padgett*, 596 S.W.2d 530 (Tex. App.—Beaumont 1979 *writ ref'd n.r.e.*), wherein the Beaumont Court of Appeals found that land used for feedlot purposes did not involve growing cattle under "natural conditions" which is a requirement of the agricultural use exemption authorized by Article VIII, § 1-d of the Texas Constitution.[9] In contrast, the "natural condition" clause is absent from both the implements of husbandry exemption and the open space land valuation provisions, which were added to the Texas Constitution[10] and the Texas Tax Code after *Padgett*. It is worth noting that the 1979 Texas Legislature defined "agricultural use" for purposes of subchapter D of Chapter 23 of the Texas Property Tax Code (i.e., open space land) to include "raising and *keeping* livestock."[11]

Given the inconsistent enforcement of the exemption that has been reported to me, I respectfully request your opinion on whether machinery and equipment used at a cattle feedlot qualify as machinery and equipment "used in the production of farm or ranch products" pursuant to Section 11.161 of the Texas Tax Code.

Thank you in advance for your consideration in this matter. Please do not hesitate to contact me if you need additional information regarding this request.

Sincerely,

Harvey Hilderbran
Chairman, House Committee on Ways & Means

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[5] Texas Comptroller Hearing 5,443 (Jan. 29, 1974)(Accession No. 7401H0241E12)(finding that a feedlot was engaged in "'farming' or 'ranching'" for purposes of a Texas sales tax exemption); See also Texas Comptroller Hearing 5,420 (July 24, 1974 (Accession No. 7407H0241E06).

[6] *See e.g.*, Texas Comptroller Policy Memo dated Oct. 30, 1990 (Accession No. 9010L1058A01).

[7] Tex. Tax Code Section 22.24.

[8] Tex. Tax Code Section 5.08.

[9] *See also* Tex. Tax Code Section 23.42(d)(1).

[10] Open space land in Article VIII, § 1-d-1 of the Texas Constitution (1978); Implements of husbandry in Article VIII, § 19a of the Texas Constitution (1982).

[11] Ch. 841, Sec. 1, 1979 Tex. Gen. Laws p. 2217; S.B. 621, 66th Legislature.