

# *Industry and Association Guidance*

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## *Implement Dealers*

*The following are the Department of Revenue's responses to the Southwestern Association's specific inquiries regarding implement dealers.*

### **AUDIT PROCESS**

The Department's tax auditors are authorized by Missouri state law to conduct compliance audits for sales, use, and withholding, corporate income and franchise tax. The Department makes every effort to conduct efficient audits that provide the least amount of interruption and inconvenience to the implement dealer as possible.

The audit period is generally limited to a three-year period, because of the three-year statute of limitations on filed returns. However, if returns have not been filed, there is no statute of limitations, and the auditor will examine at least five years of records. For example, if the business is filing sales tax returns, but is not filing consumer's use tax returns, the audit period will encompass the previous three years of sales records and at least the previous five years of purchase records.

The audit process begins with the auditor contacting the business by placing a phone call or by sending a letter. There is an initial inquiry of the business' accounting procedures and record retention. The auditor then schedules fieldwork and provides the business with an estimate of the time that the auditor plans to spend at the business location based upon the information obtained in the initial inquiry. To reduce the amount of time spent at the business location, the auditor will also request any electronic records or data files that can be provided prior to the fieldwork start date.

Prior to the first day of fieldwork, the auditor will provide the business contact with a list of records that must be available for review. The auditor will review those records with as little disruption to the day-to-day business as possible. If the volume of records is high, the auditor may suggest sampling the implement dealer's records and project the sample over the audit period rather than reviewing every transaction. This could include sampling sales transactions, purchase transactions, or both. Generally, in audits of implement dealers, the auditor would sample parts sales but examine all equipment sales.

During the examination of sales transactions, the auditor will reconcile the amount of sales made during the audit period per the dealer's records with the amounts filed with the Department. The auditor will also review sales detail to verify whether valid claims of exemption have been accepted for items sold without tax and whether the dealer has taken those exemption certificates in good faith. *See* 12 CSR 10-101.500(2)(B), Burden of Proof. If the implement dealer is found to have taken a claim for exemption while having reason to believe that the item purchased will not be used for an exempt purpose, i.e., not in good faith, the dealer will be held liable for the tax whether the item is listed as usually taxable or usually exempt from tax under Missouri Code of State Regulation 12 CSR 10-110.900, Farm Machinery and Equipment Exemptions.

To claim the agricultural exemption, the farmer should provide a Form 149 to the dealer to keep on file. The farmer should check "Agricultural" in the "Other Sales/Use Exemptions" section. The form must be updated every five (5) years per Missouri Code of State Regulations 12 CSR 10-107.100, Use of and Reliance on Exemption Certificates. The farmer may name the specific items to be purchased exempt from the implement dealer in the section at the top of the form. If the farmer leaves this blank, the implement dealer may sell any items listed in the "Usually Exempt" section of 12 CSR 10-110.900, Farm Machinery and Equipment Exemptions, under the exemption certificate in good faith. But, any other items, including those listed in the "Usually Taxable" section of the regulation, will require a separate specific signed statement of exemption from the farmer if sold without tax. This separate specific statement of exemption may be printed on the sales invoice and signed, or a separate Form 149 for the specific item may be provided.

An example of an acceptable signed statement is:

I certify the items on this invoice will be used solely, exclusively, and directly for producing farm products for ultimate sale at retail. If these items are not used for this purpose, I will be liable for the tax, interest, and penalty.

Signed \_\_\_\_\_

If the farmer gives the implement dealer an exemption certificate or signed statement claiming an exemption that the farmer is not entitled to claim, or if the farmer subsequently uses the tangible personal property in a manner inconsistent with the farmer's claim of exemption, then the farmer is liable for the tax under 12 CSR 10-107.100. The farmer, not the dealer, must pay the tax if the dealer accepted the claim for exemption in good faith. The Supreme Court of Missouri has defined "good faith" as "honesty of intention, and freedom from knowledge of circumstances which ought to put the holder of the certificate upon inquiry." If there is no claim of exemption on file, the implement dealer will be given an opportunity to obtain the certificate. If the exemption certificate cannot be obtained, the item may be held taxable in the audit.

During the examination of purchase transactions, the auditor will review invoices for all fixed assets acquired during the audit period. The auditor will also review invoices for expense purchases to determine that all applicable taxes were paid or accrued. During this review, the auditor determines if a business has purchased un-taxed items that were used internally by the business (e.g., not for resale) but did not accrue and remit tax. The auditor also reconciles the amount of use tax due per the dealer's records to the amount filed with the Department, if applicable.

In addition to the examination of sales and purchase transactions, the auditor will also examine the state income tax withheld from the employee's wages to determine if all amounts withheld were properly remitted to the Department. Federal and state income tax returns are also reviewed and reconciled to the dealer's sales records to ensure all sales are being reported. If the dealer sells tires and batteries, the auditor will review the sales of these items and reconcile the tire and battery fees reported by the dealer to the dealer's records. The auditor may also review the business records for corporate and franchise taxes.

Once fieldwork is complete, the auditor will provide a copy of the audit workpapers to the implement dealer. The dealer will be given time to review the audit workpapers and provide documentation to resolve any questionable items. The auditor will review the items in question with the dealer. After the review is complete, the audit is computed. If the dealer has concerns or questions at anytime during the audit process, the dealer may contact the auditor's supervisor or manager.

The Department's goal is to assist the dealer and simplify compliance with Missouri tax laws. This includes making the audit process as educational and beneficial to the dealer as possible.

## **MOWERS**

Section 144.030.2(22), RSMo, exempts from sales tax "all sales of farm machinery and equipment, other than airplanes, motor vehicles and trailers." To qualify for the exemption in Section 144.030.2(22), RSMo, the farm machinery and equipment must be:

- Used exclusively for agricultural purposes;
- Used on land owned or leased for the purpose of producing farm products; and
- Used directly in producing farm products to be sold ultimately in processed form or otherwise at retail or in producing farm products to be fed to livestock or poultry to be sold ultimately in processed form at retail.

A lawnmower is equipment as defined by Missouri Code of State Regulation 12 CSR 10-110.900(2)(A), Farm Machinery and Equipment Exemptions. However, the regulation also provides under paragraph (3)(F)(7) that "machinery and equipment used for a dual purpose, one purpose being agricultural and the other being nonagricultural, are not exempt."

Listed below are examples to clarify the statute and regulation:

**Example 1:** A farmer purchases a mower. The farmer only uses the mower to mow around grain bins that are used for storing grain to feed cattle that will be sold ultimately at retail. The farmer is not able to remove the grain from the bin to feed his cattle if the grass is not trimmed. The purchase of the mower is exempt from tax because the mower is used exclusively and directly for agricultural production.

**Example 2:** A farmer purchases a mower. The farmer uses the mower to mow in a vineyard for the production of grapes. The purchase of the mower is exempt because it is used exclusively and directly for agricultural production.

**Example 3:** A farmer purchases a mower. The farmer uses the mower both to mow in his orchard and to mow his lawn. The purchase of the mower is subject to tax because the mower is not used exclusively and directly for agricultural production.

## **FARM MACHINERY AND EQUIPMENT REPLACEMENTS**

Section 144.030.2(22), RSMo, provides an exemption from sales tax for sales of new or used farm machinery and equipment, repair parts, and replacement parts. To qualify for the exemption in Section 144.030.2(22), RSMo, the farm machinery and equipment must be:

- Used exclusively for agricultural purposes;
- Used on land owned or leased for the purpose of producing farm products; and
- Used directly in producing farm products to be sold ultimately in processed form or otherwise at retail or in producing farm products to be fed to livestock or poultry to be sold ultimately in processed form at retail.

12 CSR 10-110.900(2)(E), Farm Machinery and Equipment Exemptions, defines repair and replacement parts as:

Articles of tangible personal property that are components of machinery and equipment, which can be separated from the machinery or equipment and replaced. Like machinery and equipment, parts must have a degree of permanence and durability. Included in the repair and replacement part category are batteries, tires, fan belts, mufflers, spark plugs, oil filters, plow points, standard type motors, and cutting parts.

Equipment that was part of the original machinery and not essential to the operation of the machinery itself, such as cigarette lighters, radios, canopies, air-conditioning units, cabs, deluxe seats, tool or utility boxes, and lubricators, are not subject to tax when sold as part of the assembled farm machinery as set forth in 12 CSR 10-110.900(3)(F)(4), Farm Machinery and Equipment Exemptions. Until August 28, 2011, items that were not part of the assembled farm machinery and were purchased subsequent to the original purchase of the farm machinery are subject to tax because the items are not essential to the operation of the machinery itself and do not independently meet the requirements for the agricultural exemption. On or after August 28, 2011, these items are exempt from tax. Until August 28, 2011, if the implement dealer is selling, but not installing, an item that may be a replacement item, then the dealer should obtain a statement from the farmer that the item is for replacement to substantiate that the exemption on this sale was accepted in good faith. See the Legislative note below.

Listed below are examples to clarify the statute and regulation:

**Example 1:** An individual purchases a farm tractor and uses it in a manner that meets the requirements for the farm machinery exemption. The tractor includes an AM/FM radio. At a later date, the radio is broken and is replaced. The replacement radio is not subject to tax because it is a replacement part for exempt farm machinery.

**Example 2:** An individual purchases a farm tractor that qualifies for the farm exemption. The tractor is not equipped with an AM/FM radio. The individual later adds an AM/FM radio. The radio is subject to tax, if purchased prior to August 28, 2011. If purchased on or after August 28, 2011, the purchase is exempt from tax.

## **LABOR CHARGES IN CONJUNCTION WITH THE SALE OF TANGIBLE PERSONAL PROPERTY**

Section 144.021, RSMo, provides that a seller's taxable sales are based on its "gross receipts." Gross receipts are defined in Section 144.010.1(3), RSMo, as the total selling price of the sale at retail including any services that are a part of the sale.

12 CSR 10-103.600(1), Sales of Tangible Personal Property and Services, provides, "When the sale of tangible personal property and a nontaxable service are not separable, the entire sale price is taxable if the true object of the transaction is the transfer of tangible personal property." The regulation goes on to provide, "If the purchaser obtains a service as part of a transaction in which the true object is the purchase of tangible personal property, the entire sale price is taxable even if the charge for the service is separately stated." 12 CSR 10-103.600(3)(C)(1).

Listed below are examples to clarify the statute and regulation:

**Example 1:** A business purchases hose in bulk and fittings to produce complete hydraulic hoses for sale to its customers. A customer brings in a blown hydraulic hose. This hose cannot be repaired and must be replaced. The business produces new hydraulic hoses rather than special order hydraulic hoses from suppliers. A new hydraulic hose consists of the hose and connectors. The business cuts the hose to the correct length and attaches the connectors using a machine to crimp the connectors on to the hose. The new hydraulic hose produced by the business is a replacement hose for the blown hose. The charge for the new hydraulic hose, including the charge for the labor to outfit the connectors to the hose, is subject to tax even if the labor to attach the connectors is separately stated. If a hydraulic hose is used on farm equipment, the entire charge is exempt.

**Example 2:** A customer brings in a hydraulic hose with a damaged connector. This hose can be repaired by attaching a new connector. The business attaches the connector using a machine to crimp the connector to the hose. The charge for the connector is subject to tax. The charge for the labor to repair the hose, which includes the charge for the use of the machine, is not subject to tax as long as the labor to attach the connector is separately stated. If the connector is used on farm equipment, tax should not be charged.

**Example 3:** Repairs are made on non-agricultural equipment. The mechanic installs the new parts and charges sixty dollars (\$60) for the parts and fifty dollars (\$50) for labor, which is separately stated on the invoice. Tax is due on the sixty dollars (\$60) charge for the parts.

## INBOUND FREIGHT

Inbound freight is defined as a freight charge from a wholesaler to the implement dealer. In some instances it can involve a drop shipment from the wholesaler directly to the final consumer.

The taxability of inbound freight for sellers of equipment and parts is the same as the taxability of inbound freight for sellers of other tangible personal property, including the charge for the inbound freight for drop shipments. If the sale of the equipment and parts is taxable, the inbound freight is taxable. If the sale of the equipment and parts is exempt or excluded from tax, the inbound freight is also exempt or excluded from tax.

The Missouri Supreme Court has ruled that if title to merchandise passes before shipment, then the freight or delivery charges are not taxable. In the case of inbound freight, however, title usually passes after shipment. For freight to be nontaxable, the final consumer must take title to the merchandise before it leaves the wholesaler's location. For inbound shipments, the retailer cannot transfer title to the final consumer because the retailer has not acquired title from the wholesaler until the merchandise is delivered to the retailer or customer (drop shipment). In order for the implement dealer (the retailer) to legally transfer title to the final consumer before delivery, the dealer would need to first acquire title from the wholesaler or receive permission from the wholesaler to make such title transfer. If the merchandise is lost or destroyed in shipment and title transferred to the final consumer before it left the wholesaler, the final consumer – not the dealer – would suffer the loss.

The determination whether inbound freight is taxable will be done by reviewing the freight invoices as well as the sales invoices on transactions in which freight was not taxed. When additional freight is necessary because the customer requests special shipping, it should be noted on the sales invoice.

Listed below are examples to clarify the above statements:

**Example 1:** A wholesaler sells a part to an implement dealer for \$1,000 plus a separately stated freight charge of \$50, for a total of \$1,050. The wholesaler delivers the part to the implement dealer. The dealer sells that same part to a farmer for \$1,200 plus a separately stated “inbound freight charge” of \$50, plus a separately stated “outbound freight charge” of \$30, for a total of \$1,280. The farmer had the option to avoid the \$30 outbound freight charge by arranging for his own delivery from the dealer. Assuming that the part is not exempt or excluded from tax, the dealer should collect and remit tax on \$1,250. The \$50 inbound freight charge is taxable as a cost of the dealer acquiring the part. The \$30 outbound freight charge is not subject to sales tax because the delivery was an optional charge to the farmer.

**Example 2:** A wholesaler sells a part to a retailer for \$1,000 plus a separately stated freight charge of \$80, for a total of \$1,080. The retailer asks the wholesaler to drop ship the part directly to a farmer. The retailer bills the farmer for \$1,200 for the part, plus a separately stated freight charge of \$80. The farmer had no option to arrange for his own delivery from the wholesaler's location. Assuming that the part is not exempt or excluded from tax, the retailer must collect and remit tax on \$1,280. The \$80 freight charge is taxable as an element of the sale.

**Example 3:** A wholesaler sells a part to a retailer for \$1,000. Shipping fees are not normally charged as long as the retailer accepts the terms and conditions set forth by the wholesaler regarding their shipping schedule. The retailer's customer decides he needs the part overnight, which costs an additional \$50. To provide overnight shipping, the retailer adds a separately stated freight charge of \$50. The \$50 freight charge to overnight the part is not subject to tax because it is an optional charge and it was separately stated from the part purchased.

**Example 4:** A wholesaler sells a part to a retailer for \$1,000 plus a separately stated freight charge of \$50, for a total of \$1,050. The wholesaler delivers the part to the retailer. The retailer sells that same part for \$1,200 plus a separately stated "inbound freight charge" of \$50 to its customer. The retailer should collect and remit tax on \$1,250. The \$50 inbound freight charge is taxable because it is a mandatory charge required by the wholesaler to provide the part to the retailer. The retailer's customer decides he needs the part overnight, which costs an additional \$75. To provide overnight shipping, the retailer adds a separately stated freight charge of \$75 to the invoice amount of \$1,250 for a total of \$1,325. The additional \$75 freight charge to overnight the part is not subject to tax because it is an optional charge and is separately stated from the part purchased. The retailer would still collect and remit tax on the \$1,250.

**Example 5:** A farmer purchases farm machinery which qualifies for the farm exemption under Section 144.030.2(22). The farmer issues an exemption certificate to the seller on the purchase of the farm machinery. Because the farm machinery is exempt from sales tax, any freight charges are also exempt from sales tax.

## **EXTENDED WARRANTIES**

Extended warranties for non-agricultural equipment are treated like automotive extended warranties under 12 CSR 10-103.600, Sales of Tangible Personal Property and Services.

A manufacturer's warranty is included in the sales price of the original item. The warranty includes replacement parts for no additional charge. Sales tax is due on the entire sale price of the original item. The replacement parts provided under the warranty are not subject to tax.

When the dealer sells an optional extended warranty beyond the manufacturer's warranty and the sale price of the optional extended warranty is separately stated, the charge for the extended warranty is not subject to sales tax. The parts used to fulfill this extended warranty repair are subject to tax. The dealer's purchase of the parts is subject to tax unless the customer is required to pay for the parts. If the customer pays for the parts, the dealer must collect and remit sales tax on the charge for the parts.

Listed below are examples to clarify the regulation:

**Example 1:** A customer purchases a new lawnmower for personal use. Along with the equipment, the customer purchases an optional extended warranty. The extended warranty is separately stated on the invoice. The extended warranty charge is not taxable.

**Example 2:** A customer brings equipment in for repair under an extended warranty. The extended warranty covers labor only. The equipment does not qualify for the agricultural exemption. The parts used to repair the equipment are billed to the customer. The dealer must collect tax on the sales price of the parts used to repair the equipment.

**Example 3:** A customer brings equipment in for repair under an extended warranty. The extended warranty includes parts for no additional charge to the customer. The equipment does not qualify for the agricultural exemption. The dealer must pay tax on its purchase of the parts or self-accrue tax on the cost of the parts if removed from inventory.

**LEGISLATION EFFECTIVE AUGUST 28, 2011, HB458 AND SB356**

Section 144.030.2(22), RSMo, was amended in 2011 by adding the following items:

- Freight charges to the sales and use tax exemptions for agricultural-related items;
- Any accessories for and upgrades to farm machinery and equipment; and
- Rotary mowers that are used exclusively for agricultural purposes.

Implement dealers who have questions may contact the Department at (573) 751-2836. For other contact information, please access the Department's website at <http://dor.mo.gov/contact/>.