

## POLICY NOTE

### Key Findings

1. Farmers and ranchers have been negatively affected by the lockdowns, despite being deemed essential services. Median farm households in Washington lost \$821 in 2019.
2. Washington farms generate \$10.2 billion for our economy.
3. To earn a 20 percent profit margin, farms must earn more than \$5 million annually. Only 324 farms in Washington did that in 2017.
4. When lawmakers increase taxes on farmers and ranchers, the immediate effect is a reduction in farm income that is borne entirely by farm families and their employees.
5. Farmers cannot demand an increase of commodity prices to help ease the burden of tax increases; nor can they negotiate a decrease in input costs to save money while growing crops or raising livestock.
6. Instead, farmers and ranchers cut operating costs by reducing the number of employees they hire and limiting the number of acres they cultivate, leaving their employees and consumers with less income and less food respectively.
7. Farm families and the agriculture sector provide one of the state's most hardy sources of revenue and it should be allowed to operate at maximum efficiency. To do so, taxation on farm operations should be held steady or rolled back, rather than increased

# Proposals to impose a B&O tax increase on food production will reduce farm incomes

By Pam Lewison, Director, Initiative on Agriculture

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## Introduction

Current Washington state revenue is 8.6% higher than in the last budget, with the 2019-21 budget now topping \$50 billion.<sup>1</sup> Still, this is less of a revenue increase than lawmakers expected when they increased spending in a supplemental budget passed in 2020. The result is a deficit on paper between the real rise in revenue compared to the even higher level of spending that lawmakers want.<sup>2</sup>

The gap between higher revenue and the desired level of spending has caused lawmakers to look for more revenue. Raising taxes on farmers and farm communities has been considered a low-hanging fruit option by some lawmakers.

At the same time, the economic shut-down the governor ordered in response to COVID-19 has added to the problems already facing farmers across Washington state. Previously, the legislature used budget gaps as a justification to increase taxes in many areas. As recently as 2019, a Washington State Senate debate suggested agriculture was an industry that could survive additional costs imposed on it because of its supposedly low tax burden.<sup>3</sup>

Additionally, economic conditions in recent years have not been kind to agriculture. Nationally, farm income peaked in 2013 and reached its most recent nadir in 2016.<sup>4</sup> The economic forecast recently released by the Food and Agricultural Policy Research Institute predicts hard years to come for farmers and ranchers across the United States.<sup>5</sup>

Agriculture in Washington state is comprised of approximately 35,700 farms on more than 14 million acres. It is a community that ranks 14<sup>th</sup> in the U.S. in production value added to the national economy annually, and

1 "State revenues growing overall but budget deficit still projected," by Jason Mercier, Washington Policy Center, September 23, 2020, at <https://www.washingtonpolicy.org/publications/detail/state-revenues-growing-overall-but-budget-deficit-still-projected>.

2 "Revenue Review for September 23, 2020," Economic and Revenue Forecast Council, at <https://erfc.wa.gov/sites/default/files/public/documents/forecasts/rev20200923.pdf>.

3 Senate hearing on 2 SSB 5438, H-2A Agriculture Program, TVW, March 6, 2019, beginning at 2:04:58, at <https://www.tvw.org/watch/?eventID=2019031034>.

4 "Highlights from the February 2020 Farm Income Forecast," U.S. Department of Agriculture Economic Research Service, February 5, 2020, at <https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/highlights-from-the-farm-income-forecast/>.

5 "U.S. Agricultural Market Outlook: Trade Friction Baseline and a Phase 1 Scenario," Food and Agricultural Policy Research Institute, University of Missouri, March 2020, at <https://www.fapri.missouri.edu/wp-content/uploads/2020/03/2020-U.S.-Agricultural-Market-Outlook.pdf>.

it generates \$10.2 billion each year for our state's economy, helping to feed people across the country and around the world.<sup>6</sup> Yet, in 2018, the median household farm income across the U.S. was negative. At \$-821, some farm households were forced to find non-farm income to meet their financial needs.<sup>7</sup>

## Business and Occupation Tax in Washington state

The Business and Occupation Tax (B&O) is a tax imposed by lawmakers on the gross yearly sales of a business.<sup>8</sup> In Washington state, the rates and credits available, which determine the final tax rate imposed, vary significantly based on the product and economic sector.

For example, manufacturing of perishable meat and the processing of many agricultural products is taxed at .00138 percent of gross sales, while the rate for warehouse services is taxed at a rate of .00484 percent.<sup>9</sup> These two rates are of particular importance to farmers, who often use their own cold storage warehouses to keep produce, meat, seafood, and other food products fresh until they are sent to market.

The B&O taxes paid to the state in 2018 added up to an estimated \$5.5 million.<sup>10</sup> Most farmers operate on 50 acres or less and generate \$2,500 or less a year in value by sales, with 28,864 farms being noted as small farms.

## Policy analysis

Among the food producers most effected by B&O taxes are Washington's potato and apple producers. Washington is second only to Idaho in volume of potatoes produced and first in per-acre yield, representing approximately \$7.4 billion in economic benefit for the state.<sup>11</sup> The current economic downturn sharply reduced potato sales in early 2020, with the Washington Potato Commission donating one million pounds of unsold potatoes to charity to make room for the incoming harvest.<sup>12</sup> With the forced closures of schools and restaurants during the spring, the demand for processed potatoes fell even further.

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6 "Washington State Value of Agricultural Sector Production," Economic Research Service, U.S. Department of Agriculture, 2018, at [https://data.ers.usda.gov/reports.aspx?ID=17839#P0421dbce0f0d4c57be0f6387947a8ef7\\_12\\_185iT0R0x3](https://data.ers.usda.gov/reports.aspx?ID=17839#P0421dbce0f0d4c57be0f6387947a8ef7_12_185iT0R0x3).

7 "Farm Household Income Estimates," Economic Research Service, U.S. Department of Agriculture, December 2, 2019, at <https://www.ers.usda.gov/topics/farm-economy/farm-household-well-being/farm-household-income-estimates/>.

8 "Business and Occupation Tax," Washington State Department of Revenue, accessed July 2, 2020, at <https://dor.wa.gov/taxes-rates/business-occupation-tax>.

9 Business and Occupation Tax Classifications: Specialized B&O tax classifications," Washington State Department of Revenue, accessed July 2, 2020, at <https://dor.wa.gov/taxes-rates/business-occupation-tax/business-occupation-tax-classifications>.

10 "Yes, farmers pay taxes: A review of taxation imposed on Washington state farmers and ranchers." by Pam Lewison, Policy Note, Washington Policy Center, January 8, 2020, at <https://www.washingtonpolicy.org/publications/detail/yes-farmers-pay-taxes-a-review-of-taxation-imposed-on-washington-state-farmers-and-ranchers>.

11 "Potatoes," Washington Crops, Washivore, accessed July 2, 2020, at <https://www.washivore.org/potatoes>.

12 "Potato Commission to give away 100,000 spuds in Thurston County on Tuesday," The Olympian [use italics], May 30, 2020, at <https://www.theolympian.com/news/local/article243098686.html>.

The state's cyclical lockdowns and various reopening plans allowed some people to slowly return to restaurants but had a significant negative effect upon tourism.<sup>13</sup> The governor's restrictions also flattened the usual summer spike of dining out, during which processed potatoes are in high demand. The added uncertainty of ongoing school closures has left potato producers with a significant decline in their two most reliable domestic markets.

The rest of the market forecast for 2020 harvest was murky, with an expected influx of frozen french fries imported from the European Union and a higher probability of processors cancelling purchase contracts for the 2021 growing season.<sup>14</sup>

Apple farmers faced similar problems. Washington produces approximately 58 percent of all apples grown in the United States and 68 percent of the apples grown for fresh consumption.<sup>15</sup> However, as family budgets tightened and households began looking for cost-savings, fresh produce was occasionally sacrificed in favor of less costly, long-lasting canned items.<sup>16</sup> In 2011, the apple industry made up \$7.2 billion of Washington's economy.<sup>17</sup> Recent trends show that apple prices have declined by as much as 25 percent.<sup>18</sup> "Many apple growers are hanging on by their fingernails," said U.S. Apple president Jim Bair in a recent news story.<sup>19</sup>

The rapid decline in potato and apple sales highlight the need for tax stability for growers as they begin to plan for the next growing season. Profit margins in agriculture are small to begin with. Most farms operate in what the USDA categorizes the "critical zone," a profit margin of less than 10 percent.<sup>20</sup> By comparison, software companies average a 41 percent profit margin, and in the retail sector profit margins over 50 percent are common.<sup>21</sup>

While margins increase as sales increase, to earn a margin consistently above 20 percent, a farm's gross cash income must exceed at least \$5 million annually. In

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13 "Washington tourism endures staggering financial hit amid Covid-19," by Andrew McIntosh, *Puget Sound Business Journal*, June 2, 2020, at <https://www.bizjournals.com/seattle/news/2020/06/02/washington-state-tourism-suffers-covid19-financial.html>.

14 "U.S. potato industry experts see mixed foreign trade outlook, increase of French fry imports from the E.U.," *Potato News Today*, July 8, 2020, at <https://www.potatonewstoday.com/2020/07/08/us-potato-industry-experts-see-mixed-foreign-trade-outlook-increase-of-french-fries-imports-from-the-eu/>.

15 "Apples in Washington, Tree Fruit," Washington State University, accessed July 8, 2020, at [https://extension.wsu.edu/chelan-douglas/agriculture/treefruit/horticulture/apples\\_in\\_washington\\_state/](https://extension.wsu.edu/chelan-douglas/agriculture/treefruit/horticulture/apples_in_washington_state/).

16 "The Employment Situation – June 2020," news release, U.S. Department of Labor, Bureau of Labor Statistics, July 2, 2020, at <https://www.bls.gov/news.release/pdf/empisit.pdf>.

17 "Washington releases apple industry economic impact study," *Fruit Growers News*, August 31, 2012, at <https://fruitgrowersnews.com/news/washington-releases-apple-industry-economic-impact-study/>.

18 "USDA reverses decision, includes apples in grower assistance program." *Blue Book Services*, July 9, 2020, at <https://www.producebluebook.com/2020/07/09/usda-reverses-decision-includes-apples-in-grower-assistance-program/#>.

19 "Industry applauds inclusion of apples in Coronavirus Food Assistance Program." *Fruit Growers News*, July 9, 2020, accessed September 30, 2020, at <https://fruitgrowersnews.com/news/industry-applauds-inclusion-of-apples-in-coronavirus-food-assistance-program/>.

20 "Structure and Finances of U.S. Farms: Family Farm Report," by Robert A. Hoppe, 2014 edition, Economic Research Service, U.S. Department of Agriculture, December 2014, at <https://www.ers.usda.gov/publications/pub-details/?pubid=43916>.

21 "Top 10 Most Profitable US Industries," by Marisa Lifschutz, June 6, 2019, *IBIS World*, accessed October 22, 2020, at <https://www.ibisworld.com/industry-insider/analyst-insights/top-10-most-profitable-us-industries/>.



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Washington state, only 324 of 35,793 farms earned more than \$5 million in 2017. Most farms earn approximately \$20,000 a year.<sup>22</sup>

## High taxes reduce farm income

All businesses struggled in 2020, including farms and ranches. As lawmakers work on the 2021-23 budget it is important for them to bear that in mind. Many businesses face dwindling income, less frequent shopping visits, and more austere habits from consumers. Food producers are dealing with these same downward pressures.

Farms, unlike other businesses, cannot pass cost increases along to customers because commodity prices are set by the market. Farms operate like wholesale manufacturers, but farmers are not able to negotiate the sale price of their goods. Instead, agricultural sale prices are set by the daily traded market price.

So, when lawmakers increase taxes on farmers and ranchers, the immediate effect is a reduction in farm income that is borne entirely by farm families and their employees. Farmers cannot demand an increase of commodity prices to help ease the burden of tax increases; nor can they negotiate a decrease in input costs to save money while growing crops or raising livestock. Instead, farmers and ranchers cut operating costs by reducing the number of employees they hire and limiting the number of acres they cultivate, leaving their employees and consumers with less income and less food respectively.

## Conclusion

Public policy that supports businesses by allowing them to thrive is the best means of bringing the economy out of the current government-ordered economic downturn. Farm families and the agricultural sector provide Washington lawmakers with one of the state's most hardy sources of revenue and it should be allowed to operate at maximum efficiency. To do so, taxation on farm operations should be held steady or rolled back, rather than increased. With current gross farm income in the red for the last several years, it is critical for lawmakers to allow farmers to continue to feed people by operating their businesses unhampered by the burden of additional taxes.

<sup>22</sup> Economic Class of Farms by Market Value of Agricultural Products Sold and Government Payments: 2017 and 2012.” U.S. Department of Agriculture, accessed July 11, 2020, at [https://www.nass.usda.gov/Publications/AgCensus/2017/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Washington/st53\\_1\\_0003\\_0003.pdf](https://www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1,_Chapter_1_State_Level/Washington/st53_1_0003_0003.pdf).