Cite as Det. No. 05-0304, 26 WTD 21 (2007)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of . . .	)	D E T E R M I N A T I O N No. 05-0304 Registration No. . . . FY . . ./Audit No. . . . Docket No. . . .

RCW 82.04.213, RCW 82.04.050(8)(b): USE TAX – EXEMPTION -- FERTILIZER & SPRAY MATERIALS -- BAILOR OF SEED -- FARMER – PRESENT RIGHT OF POSSESSION — PERMISSION TO ENTER LAND. A bailor of seed did not have the required "possessory interest" in land to be considered a "farmer" eligible for the RCW 82.04.050(8)(b) fertilizer and spray material exemption, even though the grower gave the bailor permission to enter the land in order to help grow the crop.

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.

Bauer, A.L.J. – A seed company claims to be a farmer and exempt from the payment of retail sales and use tax on its purchases of fertilizer. We hold that Taxpayer is not a farmer and, therefore, is not exempt from the payment of retail sales tax on its purchases of fertilizers and sprays applied to crops it participates in raising.[1]

ISSUE

Did a seed company that contracted with and participated with growers in raising hybrid seed crops have the necessary "present right of possession of the land" under RCW 82.04.213 to qualify as a "farmer" – and was thus entitled to exemption from retail sales tax on the chemicals,

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been redacted.

fertilizers, and seeds that it purchased -- because it had implied or explicit permission to enter the grower's land to assist in growing the crop . . . .

FINDINGS OF FACT

[Taxpayer] sells seed.

The Audit Division (Audit) of the Department of Revenue (Department) conducted a field audit of Taxpayer's books and records for the period January 1, 1996, through June 30, 1999 (audit period). . . . This audit was limited to reviewing Taxpayers' purchases of chemicals, fertilizers, and seed on which it had not paid retail sales tax. As a result of this audit, [an] assessment was issued . . . . Taxpayer appealed to this Division . . . asserting that it should have been considered a "farmer" exempt from retail sales/use tax on its purchases/use of fertilizer and spray materials when it assisted growers in producing the seed it purchased from them. This assessment has not been paid. . . .

This appeal involves . . . circumstances in which Taxpayer, in conjunction with other growers, worked to produce hybrid . . . seed.

Taxpayer explains that hybrid . . . seed is extremely difficult to grow, and therefore is a highly profitable seed. Other seed companies pay farmers extremely high prices for a successful crop of . . . seed because those seed companies do not take on any of the expenses or the risk that a crop might fail. If the crop fails, the seed company has lost nothing.

Taxpayer paid its growers less for a successful crop, but that has been acceptable because its growers take on less of a risk. The risk is shared with Taxpayer, who assists them with the growing of the crop and shares in the expenses. . . .

During the audit period, two documents evidenced Taxpayer's agreements with growers in producing hybrid . . . seeds: (1) a written contract, and (2) a seed-growing matrix[2] on which growing responsibilities were assigned to either the grower or Taxpayer. The written contract was a standard form contract that Taxpayer used with the growers of other seeds, including outside production arrangements where the grower handled the entire operation (in which case no fertilizers or spray materials were purchased by Taxpayer).

According to Taxpayer, the contract was not an accurate representation of the course of conduct of the parties in growing hybrid . . . seeds. The matrix constituted better evidence of how its "joint" seed growing operations were actually conducted. Taxpayer and its growers generally relied upon the matrix to determine their individual growing responsibilities. Taxpayer characterizes these documents – especially the matrix -- as being necessarily flexible because it was often necessary to rearrange responsibilities.

[2] A "matrix," it is a rectangular array of entries set out by rows and columns.

At various times during the hybrid . . . seeds' growing process, fertilizers and spray materials were applied to the . . . plants to assist in their growing process. Taxpayer took advantage of economy of scale by purchasing all of the fertilizers and spray materials it used – both for the seed crops that it grew itself and the hybrid . . . seed plants it grew with growers. Taxpayer gave a resale certificate to the sellers at the time of purchase.

Under the pre-2000 contract (which contract was applicable during the audit period), Taxpayer had the following rights:

- To enter the land, and to examine, select and/or reject portions of the crop;
- To suggest fertilizers, herbicides, pesticides, and/or chemicals to assist the grower;
- To take any action as, in its opinion, is necessary to care for, harvest or deliver the crop;
- To enter the property, and supervise the crop's production.

Taxpayer supplied the hybrid . . . seed plants to the growers. The contract provided that Taxpayer retained title to the plants and the resulting seed crop at all times. If the harvested seed failed Taxpayer's tests for quality, Taxpayer could reject the harvest and not pay the grower. The contract also provided: "Grower shall at all times be and be deemed to be an independent contractor with [Taxpayer]. Grower shall have sole control of and be responsible for Grower's own operations."

Taxpayer further explains that it could have taken steps to obtain written leases, but farmers in Taxpayer's vicinity have for decades operated nearly exclusively without formalities. While Taxpayer's practice has not included obtaining written leases, it does build into its contracts with growers the ability to obtain an agreement if ever needed to protect its right of access to the crop. This lack of written proof of "possession" is not unusual. Taxpayer explains that many farmers do not have fee title to – or a written lease on – the land they farm, and that farmers regularly rotate crops from field to field, farming either their own land, or the land of another, without any written proof of "possession." According to Taxpayer, it could obtain written leases but that formality would not be in accordance with the course of practice in that area and would be an unnecessary expense.[3]

ANALYSIS

Taxpayer asserts that it is a "farmer" eligible for exemption from retail sales tax on its purchases of fertilizers and sprays applied to crops it participates in raising.

The State of Washington imposes a retail sales tax on all retail sales. RCW 82.08.020. This tax is generally collected from the consumer by the seller, who pays the tax to the state. In situations where retail sales tax is not collected, the state has the authority to collect use tax from the consumer. RCW 82.12.020.

[3] Because we cannot ascertain with any certainty in this forum the accuracy of Taxpayer's statements as set forth in this paragraph, we will accept these assertions as facts only for purposes of this determination

"Retail sales" do not include sales of fertilizers or spray materials[4] to "farmers" producing an agricultural product. RCW 82.04.050(8)(b). In those situations, no tax is due.

In RCW 82.04.213 the Washington Legislature limited the definition of "farmer" to persons growing crops for sale "upon the person's own lands or upon the lands in which the person has a present right of possession."[5] Ownership of the land denotes the holding of most of the bundle of rights, including possession, and is an interest in property.[6] Possession of the land, as one of the bundle of rights, is also an interest in property.[7] Thus, the phrase "or upon lands in which the person has a present right of possession" refers to lands in which the grower has the right to a present possessory property interest in the land.

Issue No. 1: Did Taxpayer have a possessory interest in the land because it had permission to enter the land in order to help grow seed? Taxpayer asserts that, in all situations in which it was growing seed jointly with the growers, Taxpayer had an unrestricted right of access to the land on which the seed plants were growing, and that this unrestricted right of access gave Taxpayer a possessory right in the land which qualified it to be a "farmer" under the RCW 82.04.213(2) definition.

When an owner or lessor of farmland provides permission for a person – such as Taxpayer -- to enter his property to perform an agricultural activity, does the person entering the property gain a "right of possession," and thus become a "farmer" for purposes of the exemption?

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[4] Also excluded, but not at issue in this case, are feed and seed.

[5] WAC 458-20-122 ("old Rule 122"), as in effect during the audit period, concerned the exemption for fertilizers and spray materials. It paraphrased the statutory definition of "farmer," but did not directly address the activities of seed companies. Old rule 122 was repealed effective September 26, 2003.

WAC 458-20-210 ("new Rule 210"), also concerning farmers, was amended after Taxpayer's audit period and was effective September 26, 2003. This new rule included guidance on the fertilizer and spray material exemption that was the subject of old Rule 122. Subsection (2) defines "farmer" by essentially restating RCW 82.04.213, but does not further construe the phrase "upon the person's own lands or upon the lands in which the person has a present right of possession." Subsection (4)(c)(v) provides the following example:

> (C) Seed Co. contracts with farmers to raise seed. Seed Co. provides the seed and agrees to purchase the crop if it meets specified standards. The contracts provide that ownership of the crop is retained by Seed Co., and the risk of crop loss is borne by the farmers. The farmers are obligated to pay for the seed whether or not the crop meets the specified standard. The transfer of the possession of the seed to the farmers is a wholesale sale, provided Seed Co. obtains a resale certificate from the farmers.

[6] *See Hansen v. U.S.***,** 65 Fed. Cl. 76 (Fed. Cl., 2005), explaining and tracing property's "bundle of rights" from English common law to recent U.S. Supreme Court cases; *see also United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945)("Property" within the Fifth Amendment denotes the group rights inhering in the citizen's relation to a physical thing, as the right to possess, use and dispose of it, and includes every sort of interest the citizen may possess in such thing except collateral interests incident to such relations); *Manufactured Housing Communities of Washington v. State*, 142 Wn.2d 347, 364, 13 P.3d 183 (2000); *Ackerman v. Port of Seattle*, 55 Wn.2d 400, 409, 348 P.2d 664 (1960). Washington courts have consistently recognized that "the right to possess, to exclude others, or to dispose of property" are "fundamental attribute[s] of property ownership." *Guimont*, 121 Wn.2d 586, 595, 854 P.2d 1 (1993).

[7] *See* fn 9, *supra*.

Perhaps the most common vehicle conferring a right of possession absent fee ownership is through a leasehold interest. WAC 458-20-118 (Rule 118) defines a lease as conveying "an estate or interest in a certain designated area of real property with an exclusive right in the lessee of continuous possession against the world, including the owner, and grants to the lessee the absolute right of control and occupancy during the term of the lease or rental agreement." A lease carries a present interest and estate in the property involved for the period specified therein. It gives exclusive possession of the property, which may be asserted against everyone, including the lessor. *Conaway et ux. v. Time Oil Co*., 24 Wn.2d 884, 210 P.2d 1012 (1949).

There is no assertion here that Taxpayer has entered into a lease with a grower, so that cannot be the basis for its presence on the land. In fact, its presence most closely correlates with a mere "license" to enter land. A license constitutes the authority to do a particular act, or a series of acts, upon another's land without possessing any estate therein. A license may give certain exclusive privileges to the licensee, but does not in any way exclude the licensor from full possession of the land, nor are the licensor's rights to the land in any way impaired. *Conaway, supra*.

Rule 118 defines a license as "merely a right to use the real property of another but does not confer exclusive control or dominion over the same." In discussing Rule 118's distinction between a lease and a license, the court in *Lacey Nursing Home, Inc. v. Department of Rev.*, 103 Wn. App. 169, 11 P.3d 839 (2000) stated:

> The common law distinction is similar. "A tenant's primary right is to have exclusive possession and use" of real property. William B. Stoebuck, 17 Washington Practice: Real Estate: Property Law § 6.18, at 319; *see also* § 6.3 (1995). Possession "implies exclusive control of the area possessed." Stoebuck, supra, § 6.3, at 295. A license merely grants the use of another's land. Stoebuck, supra, § 6.3, at 295.

See also Det. No. 04-0022E, 23 WTD 198 (2004).

In looking at the rights to enter and occupy property conferred between two parties, the courts look not only to the terms of any written instruments between them, but also to the circumstances under which their agreement was made, and the intentions of the parties. *Conaway*, *supra*. In this case, the grower or landowner, in allowing Taxpayer to enter his land in order to participate in the growing of seed, did not grant Taxpayer a possessory interest in the lands. Taxpayer had no right to eject others from the property, no right to exclude others from entering the property, and no right to remain on the property absent continued permission to remain. Taxpayer could not assign its right to enter the property without the express permission of the grower, and its actions on the land are strictly limited to those for which the permission was granted. In short, Taxpayer had no attributes of a right of possession in the property, and virtually all the attributes of a mere license to enter.

Moreover, Taxpayer's standard contract with the grower provided that Taxpayer would supply the grower with the "stock seed, transplants, or root stock," and that [title to the seed all other incidents of ownership the seed and the crop resulting therefrom remained in Taxpayer.] . . .

Because Taxpayer provided its grower with the seed and/or other plant stock with which to grow it hybrid . . . seed crop, Taxpayer's contract was a "seed bailment contract" consistent with RCW 15.48.270.[8]

It is generally accepted that, in the absence of any contrary provision in a bailment agreement, a bailee has such control and dominion over the bailed property that the bailee may exclude all others -- including the bailor -- from possessing it. So long as the bailee acts consistently with the purpose of the bailment, even the bailor has no right to retake possession of the property (in this case, the hybrid . . . seed plants) without the bailee's consent. 8A Am.Jur.2d Bailments § 54. Therefore, Taxpayer, as the bailor of the seed, seed stock, plant life and the seed crop, had no right to enter the bailee's land to retake possession of its crop absent the bailee's consent.

Even though Taxpayer may have obtained the implicit, or even explicit, permission to enter the land from the grower or landowner in order to participate in growing the crop, Taxpayer's interest in the land did not rise to the level of a possessory interest. Taxpayer's argument that its permission to enter the land to help in the growing of the seed constituted a possessory interest therefore fails.

. . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of November, 2005.

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[8] RCW 15.48.270 provides:

> As used in this chapter:
> (1) "Seed bailment contract" means any bailment contract for the increase of agricultural seeds where the bailor retains title to seed, seed stock, plant life and the seed crop resulting therefrom.
> (2) "Bailee" is any tenant farmer or landowner or both, who, for an agreed compensation agrees to plant agricultural seeds furnished by the bailor and to care for, cultivate, harvest and deliver to the bailor the seed resulting therefrom.
> (3) "Bailor" is any seed contractor who delivers agricultural seed to a bailee under the terms of a seed bailment contract which requires the bailee to plant, care for, cultivate, harvest and deliver the resultant seed crop to the bailor and requires the bailor to pay the bailee the amount of compensation agreed upon in the contract for the bailees' services in producing the seed.