DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0252
Gross Retail & Use Taxes
Penalty
For Years 1998, 1999, 2000, 2001

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Retail and Use Taxes—Agricultural exemption

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-4; IC § 6-2.5-3-6; IC § 6-2.5-3-7; IC § 6-2.5-5-1; IC § 6-2.5-5-2; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-5-1 through 45 IAC 2.2-5-7

Taxpayer protests the assessment of gross retail and use taxes on items obtained in retail transactions that taxpayer claims are entitled to the agricultural exemption.

II. Penalty—Request for Waiver

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of the 10% negligence penalty on that portion of the assessment where the audit denied the agricultural exemption, and requests a waiver.

STATEMENT OF FACTS

Taxpayer operates a warehousing business as well as a number of different entrepreneurial endeavors. Taxpayer stores and repackages bulk liquid farm chemicals for several large companies. One of taxpayer's other business ventures included operating a farm on approximately two hundred (200) acres of the family land. The audit found that taxpayer was not in compliance with a number of Indiana's tax statutes and regulations, and made the requisite adjustments, including one denying taxpayer the agricultural exemption from the state's gross retail and use taxes. It is this denial that taxpayer is protesting. Additional facts will be added as necessary.

I. Gross Retail and Use Taxes—Agricultural exemption

DISCUSSION

Taxpayer protests the denial of its claim for application of the agricultural exemption to purchases connected to the farming operations. The auditor's rationale for denying the exemption focused on part of the two hundred (200) acres taxpayer uses to "showcase," for marketing and research purposes, different combinations of fertilizers and soils and their effect on crop productivity. During the audit years at issue, taxpayer participated in something called "Fields of Vision OnFarm," a yearly show and tell opportunity for taxpayer to exhibit results. The audit characterized taxpayer's agricultural activity as pure marketing and research and therefore denied the agricultural exemption. In reality, the farmed acreage was devoted to the growing and selling of corn and soybeans for profit, as evidenced by documents taxpayer produced at the hearing. It should be noted that, at the hearing officer's request, taxpayer searched for records to substantiate the agricultural exemption for the 2001 tax year. As there were none, taxpayer sent a letter to the Department admitting its tax liability for 2001. Therefore, that part of taxpayer's protest has, in effect, been withdrawn.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made." Pursuant to IC § 6-2.5-2-1, a "person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state." *See also*, 45 IAC 2.2-2-1. Pursuant to IC §§ 6-2.5-3-1 through 6-2.5-3-7, an "excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana is the property was acquired in a retail transaction." An exemption is provided in IC § 6-2.5-3-4 if "the property was acquired in a retail transaction and the state gross retail tax" was paid at the time of purchase. Taxpayers are personally liable for the tax. (IC § 6-2.5-3-6). IC § 6-2.5-3-7 provides that a "person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana;" therefore, the presumption of taxability exists until rebutted. *See also*, 45 IAC 2.2-3-4.

The standards for sustaining a claim for the agricultural exemption can be found at IC § 6-2.5-5-1, IC § 6-2.5-5-2, and 45 IAC 2.2-5-1 through 45 IAC 2.2-5-7. Both IC § 6-2.5-5-1 and IC § 6-2.5-5-2 exempt certain transactions involving particular items from the state's gross retail and use taxes if the following requirements are met: taxpayer must acquire the property for "direct use in the direct production of food or commodities for sale" and be 'occupationally engaged in the production of food or commodities" to be sold "for human or animal consumption." IC § 6-2.5-5-1. Secondly, "transactions involving agricultural machinery or equipment are exempt. . . if" taxpayer "acquires it for use in conjunction with the production of food or commodities for sale" and is "occupationally engaged in the production of food or commodities which he sells for human or animal consumption." IC § 6-2.5-5-2. Taxpayer's agricultural activities meet these statutory requirements. *See*, e.g., the lease executed between taxpayer and the landowner, Section Four, "Permissible Use." Taxpayer leased the property "for the purpose of producing crops." *See also*, invoices showing amounts taxpayer received as income from sales of soybeans and corn.

45 IAC 2.2-5-1 through 45 IAC 2.2-5-7 provide definitions for the important terms in the statutes. A farmer is someone "occupationally engaged in producing food or agricultural commodities for sale. . . . Only those persons, partnerships, or corporations whose intention it is to produce such food or commodities at a profit and not those persons who intend to engage in such production for pleasure or as a hobby qualify within this definition." 45 IAC 2.2-5-1(a). Taxpayer sold the crops produced through a somewhat complicated process involving selling to local elevators for "cash today" because farmers typically do not have easy access to transportation. Taxpayer chose someone to consolidate his crop with others at the point of distribution where it was stored and then delivered to the train for transport to a processing center.

A predominant use requirement appears nowhere in either the statutes or the regulations. *See*, 45 IAC 2.2-5-3(c)(1) and 45 IAC 2.2-5-4(b). That is, to receive the exemption, taxpayers can do what taxpayer in the instant case does: operate several different businesses for profit, simultaneously, including growing crops for profit, the only requirement for the exemption.

Taxpayer has provided sufficient evidence to show that it is entitled to the agricultural exemption for the transactions at issue.

FINDING

Taxpayer's protest concerning the audit's denial of the agricultural exemption on items purchased in connection with its business of growing crops, to the extent those items were actually used to produce crops for sale in 1998, 1999, and 2000, is granted.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due because it reasonably believed it was entitled to the agricultural exemption for the retail transactions at issue.

Indiana Code Section 6-8.1-10-2.1(d) states that if a taxpayer subject to the negligence penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit taxes held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana's tax statutes and administrative regulations.

In order for the Department to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in

carrying or failing to carry out a duty giving rise to the penalty imposed. . . ." In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits.

Taxpayer has set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Therefore, given the totality of all the circumstances, waiver of the penalty on that portion of the assessment due to denial of the agricultural exemption is appropriate in this particular instance.

FINDING

Taxpayer's protest concerning the proposed imposition of the 10% negligence penalty on the audit's denial of the agricultural exemption is granted.

DMF/JMM/MR 042005