

Letter of Findings Number: 05-0513
Sales & Use Tax
Tax Period: 2002 - 2004

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ISSUES

I. Sales and Use Tax – Agricultural Exemption

Authority: [IC 6-8.1-5-1\(b\)](#), [IC 6-2.5-2-1](#), [IC 6-2.5-4-1](#), [IC 6-2.5-3-2](#), [IC 6-2.5-5-1](#), [IC 6-2.5-5-2](#); [45 IAC 15-5-3\(8\)](#), [45 IAC 2.2-5-4\(e\)](#), [45 IAC 2.2-5-1\(a\)](#); [Graham Creek Farms v. Indiana Dept. of State Revenue](#), 819 N.E.2d 151, 156 (Ind. Tax. Ct. 2004).

The taxpayer protests the assessment of use tax on several pieces of machinery.

II. Tax Administration – Ten Percent Negligence Penalty

Authority: [IC 6-8.1-10-2.1](#); [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

The Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of trucking and, to a lesser extent, excavating. His trucking and excavating operations were sole proprietorships. He also owns several hundred acres of farmland in Greene County. During the period of 2002 to 2004, taxpayer purchased a Case 1845C skid loader, a Case 580SL backhoe, a Case 850D dozer, a Cat D5H dozer, and a Hyundai 290 excavator. Taxpayer did not pay sales tax at the time the purchases were made, or use tax any time thereafter.

An audit was conducted by the Department of Revenue ("Department"), which determined that taxpayer had made several purchases, including the ones mentioned above, where no sales or use tax had been paid, but should have been. Taxpayer filed a protest, claiming that he did not owe tax on the skid loader, backhoe, dozers, and excavator. Taxpayer claimed in his protest letter that the equipment in question was purchased for use on the farm more so than the excavating business, and that the equipment was used in direct production of income. A hearing was conducted, and this Letter of Findings results.

I. Sales and Use Tax – Agricultural Exemption

DISCUSSION

Taxpayer claims that the following purchases were not subject to sales tax and that the Department's subsequent assessment of use tax is unwarranted:

1. Case 1845C Skid Loader
2. Case 580SL Backhoe
3. Case 850D and Cat D5H Dozers
4. Hyundai 290 Excavator

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."

In accordance with [IC 6-2.5-2-1](#), a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. [IC 6-2.5-4-1](#) provides that a retail transaction involves the transfer of tangible personal property. A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction and sales tax was not paid at the time of purchase. [IC 6-2.5-3-2](#).

Taxpayer claims that the property was exempt from taxes because it was used for agricultural purposes. [IC 6-2.5-5-1](#) and [IC 6-2.5-5-2](#) provide a use tax exemption for tangible personal property used for agricultural purposes. [IC 6-2.5-5-1](#) provides as follows:

Transactions involving animals, feed, seed, plants, fertilizer, insecticides, fungicides, and other tangible personal property are exempt from the state gross retail [sales] tax if:

- (1) the person acquiring the property acquires it for his direct use in the direct production of food and food ingredients or commodities for sale or for further use in the production of food or commodities for sale; and
- (2) the person acquiring the property is occupationally engaged in the production of food and food ingredients or commodities which he sells for human or animal consumption or uses for further food and food ingredient or commodity production.

[IC 6-2.5-5-2](#) provides that:

(a) Transactions involving agricultural machinery, tools, and equipment are exempt from the [sales] tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

(b) Transactions involving agricultural machinery or equipment are exempt from the [sales] tax if:

- (1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;
- (2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production; and
- (3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

[IC 6-2.5-5-1](#) and [IC 6-2.5-5-2](#) require that a taxpayer claiming the exemption to be engaged in the direct production of food. "[T]he tangible personal property for which the taxpayer seeks the exemption must be integral and essential to its production process. . . ." Graham Creek Farms v. Indiana Dept. of State Revenue, 819 N.E.2d 151, 156 (Ind. Tax. Ct. 2004). Furthermore, exemptions are strictly construed against a taxpayer who asserts them as a defense against tax liabilities. Id. (and cases cited therein).

Taxpayer claimed in his protest letter that the equipment "was used in direct production of income." He stated in another letter to the Department that "the equipment was purchased for use on the farm more so than hire." At the hearing, taxpayer went on to say that the five pieces of equipment were not used in any capacity for use in excavation for hire, and that they were only used on the farm to improve the land to make it more productive and to make it more profitable. This included clearing fence rows and emptying drainage tile. However, even if the machinery was used on taxpayer's farmland, the regulations state that "[t]he fact that an item is purchased for use on the farm does not necessarily make it exempt from sales tax." [45 IAC 2.2-5-4\(e\)](#).

Whether or not taxpayer used the equipment partially for excavation purposes outside of the work done on his farmland is negligible for the purposes of this Letter of Findings, because the actual use of the equipment on taxpayer's farmland did not go towards "direct use in the direct production, extraction, harvesting, or processing of agricultural commodities." [IC 6-2.5-5-2\(a\)](#). Taxpayer's purpose for using the equipment was in improving the land so that more crops would grow and that these crops would grow better. Taxpayer's purpose was also to make the land more profitable. In either case, the purpose for purchasing the equipment was for pre-production use on *the land*, and did not "have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces food or an agricultural commodity." [45 IAC 2.2-5-1\(a\)](#). Improving the land or making the land more profitable was not essential and integral, because these ventures in making the alterations to the land were not necessary in the respect that taxpayer could have continued to farm the land as it was. Improving the land was also not part of an integrated process, because the improvements were pre-production alterations of the land *in anticipation of* the first steps of an integrated process (i.e., "tilling").

For the foregoing reason, taxpayer has not his burden of proof pursuant to IC § 6-8.1-5-1(b), and his protest concerning an agricultural exemption from sales and use tax is denied.

FINDING

The taxpayer's protest is respectfully denied.

II. Tax Administration – Ten Percent Negligence Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to [IC 6-8.1-10-2.1](#). Indiana Regulation [45 IAC 15-11-2](#) (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The taxpayer claimed that because some other equipment he had purchased was not liable for sales tax, that the other equipment in question was likewise not liable for tax. Taxpayer has established to the Department's satisfaction that he exercised ordinary business care and prudence. Therefore, the Department will waive the penalty.

FINDING

Taxpayer's protest is sustained.

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