

**Letter of Findings Number 06-0022**  
**Sales and Use Tax**  
**For Tax Period 2002-2004**

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**ISSUE**

**I. Sales and Use Tax –Imposition of Use Tax**

**Authority:** IC § 6-8.1-5-1(b); IC § 6-2.5-2-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-5-2(a); [45 IAC 2.2-5-3\(e\)\(2\)](#); Sales Tax Information Bulletin #9 Issued April, 1992.

The taxpayer protests the assessment of use tax on an excavator.

**II. Tax Administration-Imposition of 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**

The taxpayer was a corporation that operated an auto auction house, a wholesale auto dealership, and a farm. Pursuant to an audit, the Indiana Department of Revenue, hereinafter referred to as the "Department," assessed additional use tax, interest, and penalty. The taxpayer protested the use tax assessed on an excavator and the associated penalty. A hearing was held and this Letter of Findings results.

**I. Sales Tax and Use Tax –Imposition of Use Tax**

**DISCUSSION**

The taxpayer purchased an excavator to dig a fish pond. The department assessed use tax on the taxpayer's use of the excavator. The taxpayer protested this assessment contending that the excavator qualified for an agricultural exemption from the sales tax.

Indiana Department of Revenue assessments are prima facie evidence that the tax assessment is correct. IC § 6-8.1-5-1(b). The taxpayer bears the burden of proving that the assessment is incorrect. *Id.*

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a). Indiana imposes a complementary excise tax, the use tax "on the storage, use or consumption of tangible personal property in Indiana." IC § 6-2.5-3-2(a).

Indiana provides farmers with an exemption from the sales and use tax at IC § 6-2.5-5-2(a) as follows:

Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

To qualify for the agricultural exemption, the taxpayer's use of an item of tangible personal property must meet two criteria. First the taxpayer must directly use the item in direct production. Secondly, the taxpayer must use it in the production of food for human consumption. The taxpayer used the excavator to dig a hole to be filled with water. The taxpayer then introduced immature fish into the pond with the expectation that they would live and grow to a marketable size. The first issue to be determined is whether or not the excavator was directly used in direct production. The second issue to determine is if the taxpayer used the machinery in the production of agricultural commodities.

The Indiana Department of Revenue has published Regulations and Information Bulletins to explain the application of the law to specific situations. Neither set of explanations specifically refers to aquaculture. Therefore, it will be necessary to compare the pond to a similar process that is discussed. Confinement buildings are used in a fashion similar to the taxpayer's use of the pond. The instructions explain the application of sales and use tax to confinement buildings at [45 IAC 2.2-5-3\(e\)\(2\)](#) as follows:

Confinement buildings that confine animals in order to (1) maintain physical integrity of the product (2) create and control the environment in order to facilitate production, and (3) function in conjunction with exempt machinery such as fans, thermostats, vents, cooling and heating systems are exempt. In addition, in order to qualify for the exemption, the confinement building must serve a breeding, gestation, farrowing, and nursing or finishing function. For purposes of this exemption, confinement involves holding the animal within the confines of the building or an attached confined porch area.

Sales Tax Information Bulletin #9 Issued April, 1992 also discusses the application of the sales and use tax to confinement buildings at B, Example 6 as follows:

Corporation A runs a large hog farm operation where pigs are bred, raised, slaughtered and packaged to be sold to wholesale grocers. The pigs are kept in confinement buildings. The confinement buildings maintain the integrity of the product and control the animal's growth environment to facilitate the raising process. Any property which is directly used in the process of raising the pigs, such as heat exchangers, fans, thermostats,

heat pumps, roof vents and the confinement stalls or porches would be eligible for exemption. These materials are exempt because if a person occupationally engaged in producing food for human consumption chooses to raise livestock in confinement buildings these materials are both essential and integral to the production process.

The pond is used like a confinement building to provide the proper environment for the gestation and development of the fish and to maintain the integrity of the fish. Therefore, if the pond were tangible personal property that was purchased in a retail transaction, the pond itself would be exempt from the sales and use tax just as the materials in the confinement building are exempt. However, the department did not assess use tax on the pond itself. The department assessed use tax on the excavator that was used as equipment to build the pond. It is clear that there is no exemption granted for the hammers, drills, saws, and planes used to build the confinement building. In the same way, there is no exemption for the tool used to build the pond.

Since the excavator did not meet the first test for determination as exempt from use tax, there is no reason to address the second issue of whether or not the taxpayer was actually involved in the production of agricultural commodities.

#### **FINDING**

The taxpayer's protest is denied.

### **II. Tax Administration- Ten Percent Negligence Penalty**

#### **DISCUSSION**

The taxpayer also protested the imposition of the ten percent 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 provided substantial documentation to indicate that its failure to pay the assessed use tax was due to reasonable cause rather than negligence.

#### **FINDING**

The taxpayer's protest is sustained.

*Posted: 11/29/2006 by Legislative Services Agency*

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