

Letter of Findings Number: 07-0309
Sales and Use Tax
For Tax Years 2004-05

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ISSUES

I. Sales and Use Tax—Manufacturing Exemption.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); *Indiana Dep't of Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520 (Ind. 1983).

Taxpayer protests the assessment of use tax on the purchase of transportation equipment.

II. Tax Administration—Negligence Penalty.

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

Taxpayer protests the imposition of a ten (10) percent negligence penalty.

STATEMENT OF FACTS

Taxpayer butchers, processes, and sells beef and pork in Indiana. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax and assessed a negligence penalty for the 2004 and 2005 tax years. The Department found that Taxpayer had made a variety of purchases on which Indiana sales tax was not paid at the time of purchase nor was use tax remitted to the Department. Taxpayer protested the imposition of use tax and penalty on the purchase of transportation equipment. An administrative hearing was held, and this Letter of Findings results.

I. Sales and Use Tax—Manufacturing Exemption.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(b), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had made a variety of purchases for which Indiana sales tax was not paid at the time of purchase nor was use tax remitted to the Department. The Department assessed use tax on these purchases including Taxpayer's purchase of a "Kubota tractor." The Department determined that the tractor was purchased for use in pre-production and non-production activities and was subject to use tax. Indiana imposes "an excise tax, known as the use tax," on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a).

Taxpayer maintains that as a manufacturer of pork and beef products, it acquired the tractor to transport animals during the production process. Taxpayer reasons that since the tractor is transportation equipment used in production, the tractor's purchase qualifies for an eighty-five (85) or ninety (90) percent sales and use exemption under the "manufacturing exemptions" found in IC § 6-2.5-5-3(b).

IC § 6-2.5-5-3(b) provides an exemption from sales and use tax for "manufacturing machinery, tools, and equipment... if the person acquiring the property acquires it for direct use in the direct production [or] manufacture... of other tangible personal property."

Property acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#).

[45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form."

In addition, [45 IAC 2.2-5-8\(f\)](#) addresses the taxability of "transportation equipment," as follows:

- (1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.
- (2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.
- (3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.
- (4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

Further, the court in *Cave Stone* held that transportation equipment used in the taxpayer's aggregate stone

production process was exempt from sales tax because the equipment was essential to achieving the transformation of crude stone into aggregate stone. *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). In arriving at that decision, the *Cave Stone* court found that the "focus of analysis should be whether the equipment is an 'integral part of manufacturing and operates directly on the product during production.'" *Id.*

Accordingly, transportation equipment purchased for direct use in the production of a manufactured good is subject to use tax unless the property used has an immediate effect on the good produced and is essential to the integrated process used to produce the marketable good. When equipment is used during production, during pre-production, and during post-production, the equipment will be exempt only to the extent that it is used for production purposes.

In applying any tax exemption, including the exemption found within [45 IAC 2.2-5-8\(c\)](#), the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

During the course of the protest, Taxpayer submitted information about the purchase and use of the "Kubota tractor." Taxpayer asserts that since the tractor is used to move the animals between inspection areas that the tractor is partially used directly in the manufacturing process entitling the purchases to an eighty-five (85) or ninety (90) percent manufacturing exemption. However, Taxpayer has not provided sufficient information to demonstrate that the tractor is used in an exempt manner. While Taxpayer may be required under federal government regulations to perform inspections prior to processing the animals, the inspections take place before the start of the integrated production process. Therefore, the inspections and the transporting of the animals for the inspections are pre-production activities, and the equipment used for those activities are not entitled to the manufacturing exemption.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and ten (10) percent negligence penalties for the tax years in question. Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

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 Department may waive a negligence penalty as provided in [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.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has not affirmatively established that its failure to pay the remaining deficiencies was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest to the imposition of the penalty is respectfully denied.

Posted: 12/26/2007 by Legislative Services Agency
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