

Letter of Findings: 07-0654
Sales and Use Tax
For Tax Years 2004

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ISSUES

I. Sales and Use Tax—Agricultural Equipment Exemption.

Authority: IC § 6-2.5-5-1; IC § 6-2.5-5-2; IC § 6-8.1-5-1; [45 IAC 2.2-5-3](#); [45 IAC 2.2-5-4](#); [45 IAC 2.2-5-6](#); *Graham Creek Farms v. Indiana Dep't of State Revenue*, 819 N.E.2d 151 (Ind. Tax Ct. 2004); *Rotation Prods. Corp. v. Indiana Dep't of State Revenue*, 690 N.E.2d 795 (Ind. Tax Ct. 1998).

Taxpayer protests the imposition of use tax on Taxpayer's purchase of a "small tractor."

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 is in the business of raising beef cattle. In 2004, Taxpayer purchased a "small tractor," without paying sales tax at the time of purchase by providing an agricultural equipment exemption certificate to the vendor. After an investigation, the Department found that Taxpayer's use of the "small tractor" did not meet the agricultural equipment exemption and imposed use tax, interest, and penalty on Taxpayer purchase of the "small tractor." Taxpayer protested the imposition of use tax and penalty. An administrative hearing was held, and this Letter of Findings results.

DISCUSSION

I. Sales and Use Tax—Agricultural Equipment Exemption.

Pursuant to IC § 6-8.1-5-1(c), 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 purchased a "small tractor" without paying sales tax at the time of purchase, and assessed use tax on the purchase.

IC § 6-2.5-2-1 provides:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The 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.

IC § 6-2.5-3-2(a) provides:

An 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, regardless of the location of that transaction or of the retail merchant making that transaction.

Accordingly, Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. Since Taxpayer failed to pay sales tax at the time of purchase, the Department found that the purchase was subject to use tax.

At the time of purchase of the "small tractor," Taxpayer presented the vendor with a sales tax exemption certificate providing that the equipment was exempt for use in agriculture. Taxpayer maintains that the Taxpayer's use of the "small tractor" meets the agriculture equipment exemption found in IC § 6-2.5-5-2.

IC § 6-2.5-5-2 provides, as follows:

- (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.

Accordingly, IC § 6-2.5-5-2 requires that the property for which the taxpayer is 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 Dep't of State Revenue*, 819 N.E.2d 151, 156 (Ind. Tax Ct. 2004).

[45 IAC 2.2-5-4\(e\)](#) further explains the agriculture equipment exemption as follows:

The fact that an item is purchased for use on the farm does not necessarily make it exempt from sale [sic.] tax. It must be directly used by the farmer in the direct production of agricultural products. The property in question must 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 agricultural products. The fact that a piece of equipment is convenient, necessary, or essential to farming is insufficient in itself to determine if it is used directly in direct production as required to be exempt.

Nonetheless, a tax exemption must not be read so narrowly "so as to exclude cases rightly falling within the ambit of that exemption provision." *Rotation Prods. Corp. v. Indiana Dep't of State Revenue*, 690 N.E.2d 795, 797 (Ind. Tax Ct. 1998).

Taxpayer uses the "small tractor" for one hour each day as a direct part of its cattle feeding process and for one hour three times a year in providing maintenance to an electric fence.

[45 IAC 2.2-5-3\(d\)\(7\)](#) provides that "tangible personal property purchased by a farmer for use in general farm maintenance of taxable items is taxable." Thus, since [45 IAC 2.2-5-3\(d\)\(5\)](#) provides that "purchases of fences, fencing material, gates posts, fence stretchers, and electric fence charges are taxable," property used to maintain the fence is also taxable. Thus, to the extent the "small tractor" is used for providing maintenance to the electric fence, the use is a taxable use.

However, an exemption for use in "the actual feeding process" is found at [45 IAC 2.2-5-6\(d\)](#), which provides, in relevant part, as follows:

Sales of agricultural machinery, tools, and equipment used by the purchaser directly in feeding exempt animals, poultry, etc., are exempt from tax. This exemption does not extend to the machinery, equipment, and tools used for the handling, movement, transportation or storage of feed prior to the actual feeding process.

Accordingly, Taxpayer's "small tractor" is used partially for exempt purposes and partially for non-exempt purposes. This means that the use tax liability is apportioned based upon the extent of exempt use and the extent of non-exempt use. Therefore, since the "small tractor" is used 3 hours a year--i.e., one percent of the time--for non-exempt purposes and ninety-nine percent of the time for exempt purposes, the "small tractor" use is ninety-nine percent exempt.

FINDING

Taxpayer's protest is sustained in part and denied in part.

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. 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.

Taxpayer has provided sufficient information to establish that its failure to pay the deficiency was not due to Taxpayer's negligence, but was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest to the imposition of the penalty is sustained.

CONCLUSION

In summary, Taxpayer's protest of the use tax assessment is sustained in part and denied in part--i.e., ninety-nine percent exempt, and Taxpayer's protest of the penalty is sustained.

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