DEPARTMENT OF STATE REVENUE

04-20080351.LOF

Letter of Findings Number: 08-0351
Sales and Use Tax
For the Tax Year 2006

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ISSUES

I. Sales and Use Tax–Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-8.1-5-1; 45 IAC 2.2-5-9; *Rotation Prods. Corp. v. Dep't of State Revenue*, 690 N.E.2d 795 (Ind. Tax Ct. 1998); *Indiana Waste Sys. v. Indiana Dep't of State Revenue*, 633 N.E.2d 359 (Ind. Tax Ct. 1994).

Taxpayer protests the assessment of use tax on a piece of heavy equipment used in clearing land for coal companies.

II. Penalty–Imposition.

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

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a contracting company that provides various heavy equipment services for various entities, including coal companies. Taxpayer's services include clearing land and roads, moving dirt, and contract hauling. In February 2006, Taxpayer purchased a D6H LGP Cat Dozer ("dozer") to be used in its business operations. Taxpayer provided the vendor with a sales tax exemption certificate and did not pay sales tax on the purchase of the dozer. After an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax, interest, and penalty for the 2006 tax year. The Department found that Taxpayer's use of the exemption certificate was inappropriate. Taxpayer protested this imposition of the tax. An administrative hearing was held, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Sales and Use Tax–Imposition.

DISCUSSION

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. In this instance, the Department found that Taxpayer had purchased the dozer 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.

When the state gross retail tax ("sales tax") is not properly paid on the purchase of an otherwise taxable item, the Department may assess and impose a use tax pursuant to IC § 6-2.5-3-2(a), which states:

> 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 when 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 the purchase, the Department found that the purchase was subject to use tax.

As a general rule, "all purchases of tangible personal property by persons engaged in extraction or mining are taxable." 45 IAC 2.2-5-9(a). However, Taxpayer asserts that its purchase of the dozer qualifies for the equipment exemption found in IC § 6-2.5-5-3(b), which provides what has been referred to as the "double direct" standard for the equipment exemption from sales tax. The statute provides that:

> [T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for *direct use* in the *direct production*, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing *of other tangible personal property*. (*Emphasis added*).

Not only must the equipment in question be "directly used by the purchaser in extraction or mining," it must also be "directly used in the production process." 45 IAC 2.2-5-9(c). Such a requirement means that the equipment must:

> [H]ave an immediate effect on the item being produced by mining or extraction. Property has an immediate

effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property. 45 IAC 2.2-5-9(c).

Equipment that is directly used in extraction or mining is defined in 45 IAC 2.2-5-9(e), which states:

[M]anufacturing machinery, tools, and equipment used directly in the mining or extraction process are taxable unless the machinery, tools, and equipment have an immediate effect upon mining or extracting the product. The fact that particular property may be considered essential to the conduct of the business of mining because its use is required either by law or practical necessity does not, of itself, mean that the property has an immediate effect upon the mining or extracting of the product. Instead, in addition to being essential for one of the above reason *[sic.]*, the property must also be an integral part of an integrated process.

Taxpayer maintains that the purchase of the dozer was exempt from sales tax pursuant to the exemption authority found in 45 IAC 2.2-5-9. In support of its position, Taxpayer asserts that it "purchased the equipment in question strictly to be used in the coal industry to remove trees, brush, and any other surface obstacles from the land above the coal deposits... [T]his particular dozer was purchased for the [express] use of removing overburden and filling previously mined pits with the removed overburden...."

However, IC § 6-2.5-5-3(b) requires that the equipment in question be used "in the direct production [or] manufacture... *of other tangible personal property*." (emphasis added). In the context of services, courts have focused "on whether the taxpayer's operation created a marketable good." *Rotation Prods. Corp. v. Dep't of State Revenue*, 690 N.E.2d 795, 800 (Ind. Tax Ct. 1998). The Tax Court explains: "When goods are not produced, and a service is provided, the [industrial] exemptions are properly denied." *Id.*

It is not enough that a taxpayer seeking to claim the equipment exemption acts as one part of a larger overall process that results in the production of tangible personal property. The tangible personal property must be produced "as part of [the taxpayer's] own process... not as part of an alleged process of another taxpayer." *Indiana Waste Sys. v. Indiana Dep't of State Revenue*, 633 N.E.2d 359, 363 (Ind. Tax Ct. 1994). This requirement, which arises "from the emphasized statutory language" contained in IC § 6-2.5-5-3(b), has been restated by the Tax Court, as follows:

[T]he minimum threshold requirement... is that the taxpayer who purchases the equipment in question be the entity that uses the equipment "for *his* direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." IC 6-2.5-5-3(b) (emphasis in original). *Id.* at 362-63.

Additionally, the Tax Court found that in order "to have a colorable claim for the equipment exemption" pursuant to IC § 6-2.5-5-3(b), a taxpayer must use the equipment "as part of its own process to produce other tangible personal property, not as part of an alleged process of another taxpayer." *Id*.

In the case at hand, Taxpayer provides a service to coal companies, which in turn produce a tangible personal product. As such, Taxpayer itself does not produce goods. Therefore, Taxpayer does not meet the equipment exemption requirement contained in IC § 6-2.5-5-3(b). Moreover, assuming *arguendo* that Taxpayer's service provided to coal companies resulted in the production of tangible personal property, the service would still fail to meet the requirement that the property be produced as part of Taxpayer's own process and "not as part of an alleged process of another taxpayer." Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

II. Penalty–Imposition.

DISCUSSION

Taxpayer protests 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.

Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

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

CONCLUSION

In summary, Taxpayer's protest is respectfully denied on both Issue I and on Issue II.

Posted: 10/29/2008 by Legislative Services Agency
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