

Letter of Findings Number: 08-0275
Sales and Use Tax
For the Periods 2004, 2005, and 2006

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ISSUE

I. Sales and Use Tax – Manufacturing Exemption.

Authority: IC § 6-2.5-5-3; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-11](#).

Taxpayer protests the assessment of use tax with regards to certain equipment.

II. Tax Administration – Negligence Penalty.

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 corporation in the business of manufacturing driveshafts. The Department conducted a sales and use tax audit of Taxpayer. The Indiana Department of Revenue ("Department") made several adjustments. The Department and Taxpayer resolved issues related to several adjustments prior to hearing; however, Taxpayer and the Department were unable to resolve the taxability of die assembly and changing equipment (the "Equipment"). Taxpayer protested the portion of the assessment related to the Equipment and the penalties on the assessment. The Department conducted an administrative hearing, and this Letter of Findings results.

I. Sales and Use Tax – Manufacturing Exemption.

DISCUSSION

During the course of Taxpayer's operations, Taxpayer regularly uses dies to stamp metal into the various items that Taxpayer produces. While Taxpayer is manufacturing one type of product, Taxpayer will build a new die for the next item that it will produce. The die-building process takes several hours. The Equipment in controversy is necessary for Taxpayer to assemble new dies for production and to move dies from the die-building area to the machine that actually transforms raw metal to Taxpayer's items. When the Taxpayer changes a die, the production process for which the dies are used stops until the die is successfully changed.

The issue is whether the Equipment is directly used in the direct production of Taxpayer's items. IC § 6-2.5-5-3 states:

(a) For purposes of this section:

(1) the retreading of tires shall be treated as the processing of tangible personal property; and

(2) commercial printing shall be treated as the production and manufacture of tangible personal property.

(b) Except as provided in subsection (c), transactions 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.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.

The Department's audit cited to [45 IAC 2.2-5-8](#), which provides that tools, machinery, and equipment use in pre-production activities are not exempt from sales and use tax. Taxpayer acknowledges that the exemption under [45 IAC 2.2-5-8](#) is not applicable to the Equipment. Taxpayer cites to [45 IAC 2.2-5-11](#), which provides for an exemption for tangible personal property directly used in the direct production of manufacturing tools, machinery, or equipment.

The issue is whether the Equipment is directly used in the direct production of Taxpayer's production machinery. The Equipment does not produce a machine or other equipment that Taxpayer uses in its manufacturing. Instead, the die Equipment assembles a die and changes a die on an already existing machine. Thus, the Department respectfully disagrees with Taxpayer's assertions regarding [45 IAC 2.2-5-11](#). Thus, the Equipment is not directly used in Taxpayer's production process and is not used to produce manufacturing machinery, and therefore Taxpayer's protest of use tax on the Equipment is denied.

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty on Taxpayer's use tax assessments.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-](#)

[11-2](#) further provides:

(b) "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.

(c) 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 remit use tax for the years in question was the result of reasonable application of Indiana's laws to its manufacturing business and not the result of negligence.

FINDING

Taxpayers' protest is sustained.

CONCLUSION

Taxpayer's protest of use tax on the die-changing equipment is denied and Taxpayer's protest of the penalties for the years in question is sustained.

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