

Letter of Findings: 09-0090
Sales and Use Tax
For the Year 2007

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-2; [45 IAC 2.2-5-4](#); [45 IAC 2.2-5-6](#); [45 IAC 2.2-5-8](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the assessment of tax on purchase of tangible personal property.

II. Tax Administration – 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, an Indiana farmer, is engaged in producing watermelons and plants. Pursuant to a desk audit, the Department of Revenue ("Department") assessed use tax on Taxpayer's purchase of a forklift because Taxpayer did not pay sales tax at the time of the purchase. Taxpayer protested the Department's assessment. A hearing was held. The Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department assessed use tax on Taxpayer's purchase of the forklift because Taxpayer did not pay sales tax when the transaction took place. Taxpayer protested the Department's assessment. Taxpayer claimed that it was entitled to an agricultural exemption because it purchased the forklift for agricultural use.

All tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

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.

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 provides:

(a) 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.

Generally, all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable. [45 IAC 2.2-5-6\(a\)](#). An exemption from 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. There are also additional exemptions from sales tax and use tax.

IC § 6-2.5-5-2 (a) states:

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.

[45 IAC 2.2-5-6](#), in part, further illustrates:

(b) The state gross retail tax shall not apply to sales of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing or [sic] agricultural commodities.

(c) Purchasers of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing of agricultural commodities are exempt from tax provided such machinery, tools, and equipment have a direct effect upon the agricultural commodities produced, harvested, etc. Property is directly used in the direct production, extraction, harvesting, or processing of agricultural commodities if the property in question has 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, i.e. confinement buildings, cooling, heating, and ventilation equipment. The fact that such machinery, tools, or equipment may not touch the commodity or livestock or, by itself, cause a change in the product, is not determinative.

[45 IAC 2.2-5-4\(e\)](#) further provides:

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.

Finally, [45 IAC 2.2-5-8\(d\)](#) states:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the 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 completed form, including packaging, if required.

Taxpayer's documentation showed that the forklift was used in (1) moving the containers of watermelon seeds and (2) moving the boxes containing watermelons for distribution. Taxpayer's documentation first showed that the watermelon seeds were delivered to Taxpayer's facility in large containers. Taxpayer stated that he used the forklift to move the large containers and empty the containers. The seeds from the containers were then moved to a wagon. From there, the watermelon seeds filled up a planter. However, when Taxpayer used the forklift to transport the containers, the watermelon seeds still remained as watermelon seeds in the containers. The use of forklift did not have an immediate impact on the watermelon seeds. Therefore, the use of the forklift is pre-production activity, not direct use in direct production of watermelons.

Taxpayer's documentation also showed that, after the watermelons were harvested, Taxpayer's employees manually collected the watermelons and placed them into large boxes ("Bins"). Taxpayer used the forklift to move the Bins to a temporary storage until delivery trucks arrived. Upon the delivery trucks' arrival, Taxpayer then moved the Bins from the temporary storage and loaded the Bins on to the delivery trucks for distribution. Here, when the watermelons were harvested and collected, the production of watermelons ended. Taxpayer's documentation showed that his employees manually sorted the watermelons, the finished products, and placed them into the Bins. After the watermelons were in the Bins, Taxpayer then used the forklift to move the Bins to the storage and from the storage on to the delivery trucks. The forklift did not have an immediate impact on producing and packaging the watermelons and, therefore, the use of the forklift is post-production activity.

Taxpayer's documentation showed that the forklift may be considered essential to its farming activities. However, even if Taxpayer's use of forklift is required by practical necessity, this does not itself mean that the items have an immediate effect upon the watermelons being produced. [45 IAC 2.2-5-4\(e\)](#). Taxpayer did not provide sufficient documentation showing that the forklift was directly used in direct production of watermelons or plants, nor was the use of the forklift an essential and integral part of an integrated process which produced the watermelons or plants.

FINDING

Taxpayer's protest on the imposition of sales and/or use tax is respectfully denied.

II. Tax Administration – Penalty.

DISCUSSION

Taxpayer also protests the assessment of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2\(b\)](#) further 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\(c\)](#), in part, 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 demonstrated that its failure to pay the full amount of tax due or pay a deficiency was due to reasonable cause and not due to negligence. Thus, Taxpayer's protest on the imposition of negligence penalty is sustained.

FINDING

Taxpayer's protest on imposition of negligence penalty is sustained.

SUMMARY

For the reasons discussed above, Taxpayer's protest on the imposition of sales and/or use tax is respectfully denied. Taxpayer's protest on negligence penalty is sustained.

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