

Letter of Findings Number: 09-0196
Sales/Use Tax
For the Years 2005, 2006, 2007

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ISSUES

I. Sales/Use Tax: Equipment.

Authority: [IC 6-8.1-5-1\(c\)](#); [IC 6-8.1-10-1\(e\)](#); [IC 6-2.5-5-3](#); [45 IAC 2.2-5-8](#); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

The taxpayer protests the proposed assessment of use tax on a front end loader, and repair and maintenance parts related to the loader.

II. Ten-Percent Negligence Penalty

Authority: [IC § 6-8.1-5-1\(c\)](#); [IC § 6-8.1-10-2.1\(a\)\(3\)](#); [IC § 6-8.1-10-2.1\(d\)](#); [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

Taxpayer asks the Department to exercise its discretion to abate the ten-percent negligence penalty on the ground that taxpayer believed it interpreted the applicable statutes correctly.

STATEMENT OF FACTS

The taxpayer is in the business of providing ready mix concrete, tools, and supplies to concrete contractors, home builders, and general contractors. Taxpayer uses a front end loader (the "Loader") to load raw materials into hoppers placed at the beginning of taxpayer's concrete production process.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of taxpayer for the years 2005, 2006, and 2007. The Department's audit found that taxpayer did not pay sales tax on the purchase of the Loader, or on purchases of certain parts and materials used to repair or maintain the Loader. Taxpayer believed the aforementioned equipment, parts and materials are exempt from sales and use tax under a manufacturing exemption. As a result of the audit, the Department disallowed the manufacturing exemption and assessed use tax on the aforementioned purchases. Taxpayer disagreed with the Department's assessments and submitted a protest. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

I. Sales/Use Tax: Equipment.

DISCUSSION

As provided in [IC § 6-8.1-5-1\(c\)](#), the burden of proving a proposed assessment wrong rests with the taxpayer. Taxpayer protests the proposed assessment of use tax on its purchase of the Loader, and on repair and maintenance parts purchased for use on the Loader, asserting that the Loader is an integral part of a highly automated, computerized, and integrated concrete production plant.

[45 IAC 2.2-5-8\(a\)](#) states that "[i]n general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable." However, [45 IAC 2.2-5-8\(b\)](#) notes:

The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.

As [45 IAC 2.2-5-8\(c\)](#) makes clear, the equipment must "have an immediate effect on the article being produced." [45 IAC 2.2-5-8\(d\)](#) deals with "preproduction" and states in relevant part:

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process....

Property, per [45 IAC 2.2-5-8\(f\)](#), "used for moving raw materials to the plant prior to their entrance into the production process is taxable." Taxpayer claims it uses the Loader to weigh each segregated "batch" of raw materials to verify the amount contained within that batch.

The auditor asserted that taxpayer used the Loader during pre-production, and thus did not come within the ambit of the manufacturing exemptions. During the hearing, taxpayer countered that its concrete processing cannot begin without use of the Loader. Taxpayer also argued that the Loader never moves away from its usual position in the process.

[45 IAC 2.2-5-8\(g\)](#) addresses taxpayer's arguments, providing that,

The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced." Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Taxpayer asserts that a determination of the role of a particular piece of equipment in the manufacturing process must focus on the whole manufacturing process and whether that piece of equipment plays an essential and integral part in an integrated process. Equipment that transports work in progress has been found to meet the requirements of Ind. Code § 6-2.5-5-3. *Indiana Dept. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 524 (Ind. 1983). In that case, the Indiana Supreme Court found that the equipment used to transport stone from the company's quarry to the crusher and then to stockpiles was directly used in the direct production of tangible personal property. The Cave Stone court deemed the stone work in process and, therefore, the equipment used to move it was entitled to the manufacturing exemption.

[45 IAC 2.2-5-8\(c\)](#) states in part:

(4) Because of the lack of an essential and integral relationship with the integrated production system in Example (1), the following types of equipment are not exempt:

* * *

(G) Equipment used to remove raw material from storage prior to introduction into the production process or to move finished products from the last step of production.

An analysis of the materials and explanations presented distinguishes taxpayer's case from the situation described in *Cave Stone*. In *Cave Stone*, the taxpayer began the production process by blasting, mining, and removing stone from its own quarry. The *Cave Stone* court's description of taxpayer's "entire operations" included the blasting and mining. That taxpayer used the subject equipment to move the stone, transporting unfinished work in process. Materials and arguments in this proceeding indicate that taxpayer's loading of raw materials into a hopper system is not part of the production process. Taxpayer uses the Loader to introduce raw materials to the beginning of the production process. Taxpayer does not use the Loader to transport unfinished work in process. The Loader does not have an immediate effect on the materials. The Loader, as used by the taxpayer in this case, engages in pre-production activities and, therefore, does not qualify for the manufacturing exemption. The Loader, and any tangible personal property used to maintain or repair the Loader, is subject to use tax.

FINDING

The taxpayer's protest is denied. However, the Department should review and adjust its assessment with respect to a specific invoice regarding exhaust repairs to reflect assessment of use tax only on parts, and not on services.

II. Ten-Percent Negligence Penalty

DISCUSSION

The Department's assessment included a ten-percent penalty.

Again, under IC § 6-8.1-5-1(c), "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence.

IC § 6-8.1-10-2.1(d) states that "[i]f a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

Departmental regulation [45 IAC 15-11-2\(b\)](#) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation [45 IAC 15-11-2\(c\)](#) requires that 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...."

The Department is prepared to agree that taxpayer had "reasonable" cause to believe that it was not required to pay sales tax on the purchase price of the Loader and on repair and maintenance parts used on the Loader.

FINDING

The Department agrees to waive the ten percent negligence penalty.

CONCLUSION

Taxpayer is denied as to the substantive issue of whether it was required to pay sales or use tax on the purchase of the Loader and any tangible personal property used to maintain or repair the Loader. The Department agrees to waive the ten percent negligence penalty assessed in the audit.

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