

Letter of Findings Number: 09-0611
Use Tax
For Tax Years 2006-08

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ISSUES

I. Use Tax—Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-3-8](#); [45 IAC 2.2-5-8](#).

Taxpayer protests the imposition of use tax on some items included as taxable in the audit.

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 percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana business in the wood processing industry. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax for the tax years 2006, 2007, and 2008. The Department therefore issued proposed assessments for use tax, ten percent negligence penalties, and interest for those years. Taxpayer protests a portion of the use tax assessments and the negligence penalties. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on three categories included as taxable in the audit. The first category is an air compressor which Taxpayer states is used to power exempt production machinery. The second category is a "Signode Table Tyer" which ties bundles of wood veneer in sequence. The third category is charges by a specific contractor for construction at Taxpayer's location. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(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.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(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.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

The first category of protest is an air compressor which Taxpayer states is used to power exempt production machinery. [45 IAC 2.2-5-8\(c\)](#) Example 2(A) states:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

(A) Air compressors used as a power source for exempt tools and machinery in the production process.

....

Taxpayer provided sufficient documentation to establish that the air compressor is used to power exempt production equipment. Therefore, Taxpayer is correct that the air compressor is not subject to tax. However, a review of the audit report shows no reference to an air compressor. Neither does the audit report include any item purchased for \$2,400, which is the amount Taxpayer lists as the cost of the air compressor. Therefore, while Taxpayer is correct that the air compressor is not subject to sales or use tax, the Department cannot remove an item which is not included as taxable in the audit report.

The second category of protest is a Signode Table Tyer which Taxpayer uses to bundle stacks of veneer in sequence. Taxpayer refers to [45 IAC 2.2-5-8\(d\)](#) Example 1, which states:

The production of pharmaceutical items is accomplished by a process which begins with weighing and

measuring out appropriate ingredients, continues with combining and otherwise treating the ingredients, and ends with packaging the items. Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and is taxable. Weighing and measuring equipment and all equipment used as an essential and integral part of the subsequent manufacturing steps, through packaging, qualify for exemption. Equipment which loads packaged products from the packaging step of production into storage, or from storage into delivery vehicles, is subject to tax.

(Emphasis added).

Taxpayer believes that this is analogous to its production of wood veneer and states that its customers all require that it bundle and tie the veneer in sequence in order to protect it in transit. Taxpayer provided documentation in support of this position. After review of the supporting documentation, Taxpayer is correct that the bundling process in this specific instance is integral and essential to the production process. The bundling is not a post-production activity which only affects shipping. Rather, Taxpayer's customers purchase bundles of veneer, which are tied using the Signode Table Tyer, in a manner similar to the packaging of the pharmaceuticals described in [45 IAC 2.2-5-8\(d\)](#) Example 1.

The third protest category is charges by a specific contractor. Taxpayer states that the contractor paid sales tax at the time it purchased the materials and believes that use tax should not now be paid. Taxpayer has provided documentation in support of this position.

[45 IAC 2.2-3-8](#) states:

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [\[45 IAC 2.2-5\]](#)).

(Emphasis added).

Therefore, since the contractor paid sales tax at the time it purchased the materials, these amounts are not subject to use tax.

In conclusion, the air compressor cannot be removed since it was not included in the audit report as a taxable item. The Signode Table Tyer bundles the veneers in a manner which satisfies the test found at [45 IAC 2.2-5-8\(d\)\(1\)](#). The specific contractor paid sales tax on the materials at the time it purchased them. Those materials are therefore not subject to use tax, as provided by [45 IAC 2.2-3-8\(b\)](#).

FINDING

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

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued a proposed assessment and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty and states that the equipment discussed in Issue I was used at least for some exempt purposes. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) 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.

(Emphasis added.)

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

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.

In this case, Taxpayer incurred an assessment which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has established

that the assessment was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer is partially sustained and partially denied on Issue I. Taxpayer is sustained regarding its protest of use tax assessed on the Signode Table Tyer and contractor's charges. Taxpayer is denied regarding the air compressor, since the air compressor was not included as taxable. Taxpayer is sustained on Issue II regarding imposition of penalty.

Posted: 04/28/2010 by Legislative Services Agency

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