

Letter of Findings: 09-0482
Sales and Use Tax
For Tax Years 2006, 2007

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ISSUES

I. Sales and Use Tax—Agricultural Equipment Exemption.

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 § 6-2.5-5-1; IC § 6-2.5-5-2; IC § 6-8.1-5-1; [45 IAC 2.2-5-3](#); [45 IAC 2.2-5-4](#); [45 IAC 2.2-5-6](#); *Graham Creek Farms v. Indiana Dep't of State Revenue*, 819 N.E.2d 151 (Ind. Tax Ct. 2004); *Rotation Prods. Corp. v. Indiana Dep't of State Revenue*, 690 N.E.2d 795 (Ind. Tax Ct. 1998).

Taxpayer protests the imposition of use tax on taxpayer's purchases of various items.

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 (10) percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of raising hogs. Taxpayer grows and harvests crops as part of its hog-raising activities. Taxpayer also devotes a smaller portion of time and resources to log transporting. During the 2006 and 2007 tax years (the "Tax Years"), taxpayer purchased a number of items used in conjunction with taxpayer's business. The Department conducted an audit of taxpayer's business for the Tax Years, assessing use tax on items purchased by taxpayer. Taxpayer protested the imposition of use tax and penalty. An administrative hearing was held, and this Letter of Findings results.

DISCUSSION

I. Sales and Use Tax—Agricultural Equipment Exemption.

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.

The Department found that Taxpayer had purchased a number of items without paying sales tax at the time of purchase, and assessed use tax on the purchases.

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(a) specifies that:

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 where the gross retail tax ("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 purchase, the Department assessed use tax on those purchases.

Taxpayer maintains that the taxpayer's use of the purchased items meets the agriculture equipment exemption found in IC § 6-2.5-5-2.

IC § 6-2.5-5-2 provides, as follows:

- (a) Transactions involving agricultural machinery, tools, and equipment are exempt from the [sales] tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.
- (b) Transactions involving agricultural machinery or equipment are exempt from the [sales] tax if:
 - (1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;
 - (2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production; and
 - (3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

Accordingly, IC § 6-2.5-5-2 allows an exemption for property the taxpayer can sufficiently claim is engaged in

the direct production of food. "[T]he tangible personal property for which the taxpayer seeks the exemption must be integral and essential to its production process...." *Graham Creek Farms v. Indiana Dep't of State Revenue*, 819 N.E.2d 151, 156 (Ind. Tax Ct. 2004).

[45 IAC 2.2-5-4\(e\)](#) further explains the agriculture equipment exemption as follows:

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.

Nonetheless, a tax exemption must not be read so narrowly "so as to exclude cases rightly falling within the ambit of that exemption provision." *Rotation Prods. Corp. v. Indiana Dep't of State Revenue*, 690 N.E.2d 795, 797 (Ind. Tax Ct. 1998).

During the administrative hearing, taxpayer explained that it needed some of the subject items for the maintenance of taxpayer's hog-raising facilities, including ventilation, feeding, and waste disposal systems.

[45 IAC 2.2-5-3\(d\)](#) provides that certain "tangible personal property purchased by a farmer for use in general farm maintenance of taxable items is taxable." Those taxable items include:

[T]angible personal property to be used in managerial, sales, or other farm activities not directly related to the production of food.... The following farm activities are not directly related to the production of food or agricultural commodities: farm management and administration; selling and marketing; exhibition of farm products; safety and fire prevention; illumination for farm buildings, transportation of animals, poultry, feed, fertilizer, etc., to the farm for use in farming; and transportation of animals, poultry, and other farm produce from the farm to market[;] AND

Buildings which only protect the animals from adverse weather conditions....

Additional taxable items include:

[P]roperty to be incorporated into real estate in such a manner as to become part of the real estate... [;] AND

Materials purchased for use in construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance, or improvement of farm buildings incorporated into realty....

However, certain items that a farmer uses in the farmer's business may qualify for an exemption from use tax. For instance, [45 IAC 2.2-5-6\(d\)](#) details, in relevant part, as follows:

Sales of agricultural machinery, tools, and equipment used by the purchaser directly in feeding exempt animals, poultry, etc., are exempt from tax. This exemption does not extend to the machinery, equipment, and tools used for the handling, movement, transportation or storage of feed prior to the actual feeding process.

[45 IAC 2.2-5-3\(e\)](#) specifies the following exemptions:

(1) Heating, cooling, and ventilation equipment for agricultural production is exempt when it is directly used in the direct agricultural production process provided that such equipment is directly used in the production process, i.e. has an immediate effect on the article being produced.

(2) Confinement buildings that confine animals in order to (1) maintain physical integrity of the product, (2) create and control the environment in order to facilitate production, and (3) function in conjunction with exempt machinery such as fans, thermostats, vents, cooling and heating systems, are exempt. In addition, in order to qualify for the exemption, the confinement building must serve a breeding, gestation, farrowing, and nursing or finishing function. For purposes of this exemption, confinement involves holding the animal within the confines of the building or an attached confined porch area.

And [45 IAC 2.2-5-4\(d\)](#) lists the following descriptions of exempt items:

(1) Livestock and poultry sold for raising food for human consumption and breeding stock for such purposes.

(2) Feed and medicines sold for livestock and poultry described in Item (1).

(3) Seeds, plants, fertilizers, fungicides, insecticides, and herbicides.

(4) Implements used in the tilling of land and harvesting of crops therefrom, including tractors and attachments.

(5) Milking machines, filters, strainers, and aerators.

(6) Gasoline and other fuel and oil for farm tractors and for other exempt farm machinery.

(7) Grease and repair parts necessary for the servicing of exempt equipment.

(8) Containers used to package farm products for sale.

(9) Equipment designed to haul animal waste.

(10) Equipment such as needles, syringes, and vaccine pumps.

As a result of taxpayer's additional documents, pictures, and explanations, taxpayer has satisfied its burden of proof with respect to assertions of exempt status for the following items ("Exempt Items"):

Parts purchased for repair of grain conveyor;

Parts purchased for repair of ventilation systems in confinement buildings;

Replacement pit fans used for ventilation systems in confinement buildings;

Parts purchased for repairs to confinement buildings;
Parts purchased for repairs to pumps used to move liquid materials between confinement buildings;
Parts purchased for repairs to hog-feeding equipment;
Parts purchased for repairs to combine, planting, and tilling machines;
Parts purchased for repairs to grain elevators on taxpayer's property.
However, taxpayer did not satisfy its burden of proof with respect to the following items ("Taxable Items"):
Parts purchased for repairs on taxpayer's home;
Stone and related materials used to build dock next to lagoon on taxpayer's property;
Parts purchased for erosion control of farming field waterway;
Parts purchased for repair to high pressure water-spraying machines used to clean facilities;
Parts purchased for repairs to trucks used for hauling feed, logs, and other materials between farming locations;
Tarps used to cover truck beds while transporting feed during harvest process; and while transporting from grain elevators to confinement buildings;
Parts purchased for repair to a well;
Parts purchased for repairs to high power blowers used to dust equipment;
Parts purchased for repairs to lawn-mowing equipment used on taxpayer's property.

Taxpayer's purchase of a truck used to haul manure could enjoy a partial exemption, but taxpayer has failed to show an apportionment of time used for waste transporting, spreading, and disposal, compared to the remainder of time taxpayer used the truck to haul other materials. Therefore, this truck falls under Taxable Items.

Accordingly, taxpayer has demonstrated that taxpayer's inventory of parts and materials purchased during the Tax Years contains both Exempt Items and Taxable Items.

FINDING

Taxpayer's protest is sustained in part and denied in part, subject to review in a supplemental audit.

II. Tax Administration—Negligence Penalty.

DISCUSSION

In addition to proposed assessments, the Department also assessed ten (10) percent negligence penalties for the Tax Years. Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... 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.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), as follows:

The department shall waive the negligence penalty imposed under [\[IC 6-8.1-10-2.1\]](#) 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 pay sales and use tax was not due to Taxpayer's negligence, but was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest to the imposition of the penalty is sustained.

CONCLUSION

In summary, Taxpayer's protest of the use tax assessment is sustained in part and denied in part, subject to a supplemental audit; and Taxpayer's protest of the penalty is sustained.

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