DEPARTMENT OF STATE REVENUE

04-20100513.LOF

Letter of Findings Number: 10-0513
Use Tax
For Tax Years 2007-08

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ISSUES

I. Use Tax–Manufacturing Exemption; Public Transportation

Authority: IC § 6-8.1-5-1(c); 45 IAC 15-3-2(d)(1); IC § 6-2.5-5-2; 45 IAC 2.2-5-1(a); 45 IAC 2.2-5-4(a); IC § 6-2.5-5-3(b); 45 IAC 2.2-5-8(c)(2)(E); IC § 6-2.5-5-27

Taxpayer protests the imposition of use tax on crushed stone and rocks, which it believes are exempt; Taxpayer also protests the imposition of use tax on hauling equipment and parts.

II. Tax Administration–Negligence Penalty and Interest

Authority: IC § 6-8.1-10-1(e); IC § 6-8.1-10-2.1; 45 IAC 15-11-2(b),(c); 45 IAC 15-3-2(d)(1)

Taxpayer protests the imposition of a ten percent negligence penalty and the assessment of interest.

STATEMENT OF FACTS

The Audit Report states that the Taxpayer operates a chip mill, with a chip mill being "a stand-alone facility that converts pulpwood into chips." As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on all of its purchases which were subject to sales tax during the tax years 2007 and 2008. The Department therefore issued proposed assessments for use tax, interest, and a ten percent negligence penalty. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Manufacturing Exemption; Public Transportation

DISCUSSION

Taxpayer states in its protest letter that "for the periods ending 12/31/07 and 12/31/08" the Department assessed "back Sales Tax, penalties, and interest" and that the Taxpayer is "protesting this entire liability." Taxpayer argues that the IRS (i.e., the Internal Revenue Service) considered Taxpayer "an Agricultural Entity," and that an employee of the DOT told the Taxpayer "that the DOT also considered them as being Agricultural and because all of the trucks were farm plated they would not be required to pay sales tax on the vehicles, repairs, or fuel." In its protest letter, Taxpayer states:

> This is the only reason that the sales tax was not paid on these items, because an employee of the State of Indiana told them they did not have to. They should not be penalized for doing as they were instructed.

Taxpayer further states that it was after the audit that the Department informed Taxpayer that Taxpayer was not engaged in agricultural production. Before turning to an examination of Taxpayer's arguments, 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).

As noted supra, Taxpayer "operates a chip mill." The audit report describes the process thusly:

> A chip mill is a stand-alone facility that converts pulpwood into chips. The taxpayer uses a portable in-woods chipper to produce chips directly at the logging site. The wood chips are transported with the taxpayer's trucks to a paper mill where they are used to make paper.

Regarding Taxpayer's argument that the IRS and DOT told Taxpayer it was an Agricultural Entity, any advice that Taxpayer may have received from other agencies is not binding upon the Department. If Taxpayer wanted to know the Indiana sales/use tax implications in the operation of a chip mill, then Taxpayer should have requested a ruling from the Department (See 45 IAC 15-3-2(d)(1)). For Indiana tax purposes, Taxpayer is not engaged in agricultural production. As IC § 6-2.5-5-2 states:

> (a) 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.
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> (b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:
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> (1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;
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> (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
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> (3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

45 IAC 2.2-5-1(a) also states in relevant part, "'Farming' means engaging in the commercial production of food or agricultural commodities as a farmer[,]" and 45 IAC 2.2-5-4(a) states, "Agricultural exemption certificates

may be used only if the purchaser is occupationally engaged in the business of producing food or commodities for human, animal, or poultry consumption for sale or for further use in such production." Taxpayer's operation of a chip mill thus does not come within the scope of agricultural production.

Turning to specific protested items, Taxpayer states that "six items listed for crushed stone and rock" should be exempt. Taxpayer argues that "[t]his material is required for the Chipper and other equipment to be set on to operate. Without it, the Chipper would not be able to operate." Taxpayer concludes that the materials are "part of the manufacturing process and should not be subject to the sales tax." Taxpayer does not cite to any statutes or regulations for this proposition, but the Department notes the so-called "double direct test" that is found in IC § 6-2.5-5-3(b):

> [t]ransactions 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. [Emphasis added]

Taxpayer asserts that the six items listed for crushed stone and rock meet this standard and qualify for the exemption. The Department notes that 45 IAC 2.2-5-8(c)(2)(E) states, as an example, that "A work bench used in conjunction with a work station or which supports production machinery within the production process" is exempt. At the hearing, Taxpayer indicated that the crushed stone is left/remains at the location after the portable chipper is used. In the present case, the crushed stone is not a piece of equipment, and thus it is dissimilar to the work bench example.

Next, Taxpayer argues that it is "hauling material that they do not own, then the equipment and parts would not be subject to the sales tax." Taxpayer states:

> Basically [Taxpayer] is contracted to cut the timber, process the chips, and haul the chips to the paper mill. At that point the money is split on the agreed upon percentages. The auditor took the position that since the Lease Agreement that [Taxpayer] has the landowner sign says that all timber is free of all liens and mortgages, that [Taxpayer] is purchasing the timber.

At the hearing Taxpayer stated that it is not known before the chips go to the paper mill what the going price for chips will be, so a percentage is agreed upon in advance. The auditor, after reviewing the "Lease Agreement" between Taxpayer and landowner(s), concluded that Taxpayer purchased the wood and thus Taxpayer owned the chips. The agreement is titled as a "Lease Agreement," and states in relevant part:

> That said all timber that is purchased is free of all liens and/or mortgages. First Party [i.e., Taxpayer] will not be held liable and/or responsible for any liens and/or mortgages on said timber. [Emphasis added]

As noted, Taxpayer bears the burden of proof under IC § 6-8.1-5-1(c). The Department finds that Taxpayer acquired the chips, and thus Taxpayer is not entitled to the public transportation exemption found in IC § 6-2.5-5-27, since Taxpayer was hauling its own chips. The agreement states that the timber is "purchased." Taxpayer and the landowner agree to a percentage of the paper mill price.

Taxpayer also protested "sales tax on the purchase of a 89 Chevy Pick-Up truck," but Taxpayer withdrew that protested issue at the hearing.

FINDING

Taxpayer's protest is denied

II. Tax Administration–Negligence Penalty and Interest

DISCUSSION

Taxpayer protests the imposition of interest with respect to the assessment. Under IC § 6-8.1-10-1(e), interest cannot be waived. Taxpayer also protests the imposition of the negligence penalty pursuant to IC § 6-8.1-10-2.1. The Department also 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.

And 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. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (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. [Emphasis added]

Taxpayer's argument is that it relied upon the IRS and DOT. As Taxpayer puts it, "the only reason that the sales tax was not paid on these items, [was] because an employee of the State of Indiana told them they did not have to." However, as noted, Taxpayer did not ask the Department for a written ruling under 45 IAC 15-3-2(d)(1). Taxpayer has not established that the assessment arose due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

CONCLUSION

In summary, Taxpayer's protests of the sales/use tax, penalty, and interest assessments are denied.

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