

**Letter of Findings Number: 04-20100709**  
**Sales and Use Tax**  
**For the Period 2007 - 2009**

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**ISSUES**

**I. Sales and Use Tax— Exempt Sales.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; [45 IAC 2.2-8-12](#); [45 IAC 2.2-5-3](#); [45 IAC 2.2-5-4\(a\)](#).

Taxpayer protests that certain sales were exempt from the requirement to collect sales tax.

**II. Tax Administration—Negligence Penalty.**

**Authority:** IC § 6-8.1-5-1; 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 operates a retail store that sells feed, supplies, souvenirs, and other items. An audit of Taxpayer was conducted by the Indiana Department of Revenue ("Department"), which resulted in a proposed assessment, interest, and a ten percent negligence penalty. Taxpayer filed a protest of the proposed assessment and the imposition of a negligence penalty. An administrative hearing was held, and this Letter of Findings results. More facts will be provided below as needed.

**I. Sales and Use Tax—Exempt Sales.**

**DISCUSSION**

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 § 6-2.5-2-1; IC § 6-2.5-3-2. With regards to the proposed assessment, under IC § 6-8.1-5-1(c) the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made.

In its protest letter Taxpayer describes the items at issue in the protest as "bedding and straw" (at the hearing Taxpayer described it as wood chips/bedding materials). Taxpayer sold the bedding materials without collecting sales tax, and without receiving exemption certificates from the purchaser. The Audit Report states the following:

During the course of the audit the taxpayer produced [nine] exemption certificates to validate exempt sales.

The taxpayer maintained inadequate records for recording, linking, and tracking exempt sales to exempt customers.

And further the Auditor noted in the report:

It is the taxpayer's position that all of the farm animal feed, grains, vitamins and minerals, and bedding sales are to farmers engaged in direct agricultural production. It is the taxpayer's position that no exemption certificates are necessary for sales to farmers directly engaged in direct agricultural production because they are the only individuals who purchase livestock feed and other necessities.

The Department notes that [45 IAC 2.2-8-12](#) states in pertinent part:

(a) Exemption certificates may be issued [sic.] only by purchasers authorized to issue such certificates by the Department of Revenue. Retail merchants, manufacturers, wholesalers and others who must register with the Department of Revenue and who qualify to purchase exempt from tax under this Act [[IC 6-2.5](#)] may issue exemption certificates with respect to exempt transactions. All persons or entities not required to register with the Department as retail merchants, manufacturers, or wholesalers, and who are exempt under this Act [[IC 6-2.5](#)] with respect to all or a portion of their purchases are authorized to issue exemption certificates with respect to exempt transaction provided an exemption number has been assigned by the Department of Revenue, or provided that the Department of Revenue has specifically provided a form and manner for issuing exemption certificates without the need for assigning an exemption number.

(b) Retail merchants are required to collect the sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used by the purchaser for an exempt purpose.

(c) All retail sales of tangible personal property for delivery in the state of Indiana shall be presumed to be subject to sales or use tax until the contrary is established. The burden of proof is on the buyer and also on the seller unless the seller receives an exemption certificate.

(d) Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof. The mere filing of a Registered Retail Merchant Certificate number is not sufficient to relieve the seller of the responsibility to collect the sales tax or prove exempt use by the buyer.

(e) No exemption certificates are required for sales in interstate commerce, however, proper records must be maintained to substantiate such sales.

(f) An exemption certificate issued by a purchaser shall not be valid unless it is executed in the prescribed and approved form and unless all information requested on such form is completed.

(g) An exemption certificate or other evidence supporting an exempt sale must be maintained by the seller for at least three (3) years after the due date of the tax return upon which such exempt transaction is reported.

(h) Exemption certificates may be reproduced provided no change is made in the wording or content. (Emphasis added).

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 protest argues that the "bedding and straw" that was sold was exempt from sales tax since it was to "cattle farmers." Taxpayer in its protest letter stated it was providing the Department with "about 25 [exemption] certificates which cover most of the cattle farmers doing business with the [Taxpayer]." After examining the exemption certificates, the Department notes that the majority of the exemption certificates were for feed. And regarding the exemption certificates provided with the protest, the Department is unable to determine from the exemption certificates which sales the exemption certificates apply to—Taxpayer did not provide invoices that would link the sales to the exemption certificates.

Taxpayer also cites to [45 IAC 2.2-5-3](#)(c) and [45 IAC 2.2-5-3](#)(e) regarding exempt sales to farmers. The Audit Report noted the problem with this line of argument:

The audit revealed exempt sales of shavings and straw during the sample periods. It could not be determined whether the sales of straw and shavings were to farmers, or for decorative, insulation, or landscaping purposes, or to pet owners. Exemption certificates were unable to be provided or linked pursuant to the audit. Therefore, no proof that the items were purchased in an exempt manner could be provided.

In other words Taxpayer has not established that the sales were to farmers; Taxpayer did not establish that the shavings and straw were going to be used in an exempt manner under [45 IAC 2.2-5-3](#).

#### FINDING

Taxpayer's protest is respectfully denied.

## II. Tax Administration—Negligence Penalty.

#### DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty as it relates to sales tax.

The Department notes that under IC § 6-8.1-5-1(c) that "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-11-2](#) further provides:

(b) "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.

(c) 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.

(Emphasis added).

Taxpayer argues that it operates in "a small farming community and the [Taxpayer] [is] aware of the nature of their customer's use of their livestock products." As is evidenced by the exemption certificates provided at the

hearing, Taxpayer has also shown that it is now getting exemption certificates. Taxpayer has established that its failure to collect the tax was not due to negligence.

**FINDING**

Taxpayer's argument is sustained.

**SUMMARY**

Taxpayer's protest of the exempt sales issue is respectfully denied. Taxpayer's protest of the negligence penalty is sustained.

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