

Letter of Findings: 04-20100740
Use Tax
For the Year 2008

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ISSUES

I. Use Tax – Agricultural Production Exemption.

Authority: 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 § 6-2.5-5-3; IC § 6-8.1-5-1; [45 IAC 2.2-5-1](#); [45 IAC 2.2-5-3](#); [45 IAC 2.2-5-4](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indianapolis Fruit Co. v. Indiana Dep't of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998).

Taxpayer protests the imposition of use tax on a load chute and associated hardware.

II. Tax Administration – Imposition of Negligence Penalty.

Authority: IC § 6-8.1-10-2.1, [45 IAC 15-11-2](#).

Taxpayer protests the assessment of negligence penalty.

STATEMENT OF FACTS

Taxpayer raises pigs for food production. The Indiana Department of Revenue ("Department") assessed Taxpayer use tax on its purchase of a load chute and associated hardware because Taxpayer had purchased these items in 2008 without paying sales tax. Taxpayer protested that the load chute and associated hardware were exempt from sales and use tax because Taxpayer used them directly in its direct production process. A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Use Tax – Agricultural Production Exemption.

DISCUSSION

On initial review, the Department found that Taxpayer had purchased the load chute and associated hardware without paying sales tax at the time of purchase, and assessed use tax on the purchase.

Taxpayer contends that Taxpayer's use of the load chute qualified for an exemption from use tax, therefore, Taxpayer did not pay the sales tax at the time of purchase.

As a threshold issue, it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Furthermore, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). IC § 6-2.5-5-3(b), like all tax exemption provisions, is strictly construed against exemption from the tax. Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted). Additionally "[e]xemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." Id.

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. 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. Furthermore, IC § 6-2.5-5-1 and IC § 6-2.5-5-2 exempt tangible personal property used in agricultural production. Both of these exemptions require a taxpayer to be engaged in production. The fact that an item is purchased for use on a farm does not necessarily make it exempt. [45 IAC 2.2-5-4\(e\)](#). A taxpayer must also show how the tangible personal property for which it seeks an exemption is directly used in its direct production process. IC § 6-2.5-5-1(a); Indianapolis Fruit Co. v. Indiana Dep't of State Revenue, 691 N.E.2d 1379, 1383 (Ind. Tax Ct. 1998). In other words, the tangible personal property for which Taxpayer seeks exemption must be integral and essential to its production process, a determination that is often made by identifying the points where production begins and where it ends. [45 IAC 2.2-5-1\(a\)](#); [45 IAC 2.2-5-4\(e\)](#); Indianapolis Fruit, 691 N.E.2d at 1383-84.

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) provides:

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.

IC § 6-2.5-3-4 provides:

- (a) The storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if:
 - (1) the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property; or
 - (2) the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24](#)(b), and the property is being used, stored, or consumed for the purpose for which it was exempted.
- (b) If a person issues a state gross retail or use tax exemption certificate for the acquisition of tangible personal property and subsequently uses, stores, or consumes that property for a nonexempt purpose, then the person shall pay the use tax.

IC § 6-2.5-5-1 provides:

Transactions involving animals, feed, seed, plants, fertilizer, insecticides, fungicides, and other tangible personal property are exempt from the state gross retail tax if:

- (1) the person acquiring the property acquires it for its direct use in the direct production of food and food ingredients or commodities for sale or for further use in the production of food and food ingredients or commodities for sale; and
- (2) the person acquiring the property is occupationally engaged in the production of food and food ingredients or commodities which it sells for human or animal consumption or uses for further food and food ingredient or commodity production.

IC § 6-2.5-5-2 provides:

- (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 its direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.
- (b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail 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 it 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.

The exemption for agricultural production is further explained at [45 IAC 2.2-5-1](#)(a) states in relevant part: Definitions. "Farmers" means only those persons occupationally engaged in producing food or agricultural commodities for sale or for further use in producing food or such commodities for sale. These terms are limited to those persons, partnerships, or corporations regularly engaged in the commercial production for sale of vegetables, fruits, crops, livestock, poultry, and other food or agricultural products. Only those persons, partnerships, or corporations whose intention it is to produce such food or commodities at a profit and not those persons who intend to engage in such production for pleasure or as a hobby qualify within this definition.

"Farming" means engaging in the commercial production of food or agricultural commodities as a farmer.

"To be directly used by the farmer in the direct production of food or agricultural commodities" requires that 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 food or an agricultural commodity.

(Emphasis added).

[45 IAC 2.2-5-3](#) further elaborates:

- (a) Definitions: Fertilizer. The term "fertilizer" means a commodity which contains one or more substances to increase the available plant food content of the soil and which becomes a part of the products grown therein. Farmer. For definition of "farmer" as used in this regulation [[45 IAC 2.2](#)] refer to Regs. 6-2.5-5-1(010) [[45 IAC 2.2-5-1](#)].

Farming. The term "farming" means engaged in the commercial production of food or agricultural commodities as a "farmer".

- (b) In general, purchases of tangible personal property by farmers are taxable. The exemptions provided by

this regulation [45IAC 2.2] apply only to seeds, fertilizers, fungicides, insecticides, and other tangible personal property to be directly used by the farmer in the direct production of food and agricultural commodities. This exemption is limited to "farmers".

(c) The state gross retail tax shall not apply to:

- (1) Sales to farmers and to other persons occupationally engaged in the business of producing food and agricultural commodities for human, animal, and poultry consumption (either for sale or further use in producing such food and agricultural commodities for sale) of seeds, plants, fertilizers, fungicides, insecticides, and other tangible personal property to be directly used by the purchaser in the direct production of food and agricultural commodities.
- (2) Sales to farmers of seeds, plants, fertilizers, fungicides, insecticides, and other tangible personal property to be directly used by the farmer in the direct production of food or agricultural commodities for human, animal, or poultry consumption either for sale or for further use in producing food and agricultural commodities for sale are exempt from tax. "To be directly used in the direct production of food or agricultural commodities for human, animal, or poultry consumption either for sale or for further use in producing food and agricultural commodities for sale," 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 food or an agricultural commodity.
- (3) Seeds and plants. Sales to farmers of seeds and plants for sale or for further use in producing food and agricultural commodities for sale are exempt from tax provided such seeds and plants are used directly in farming.
- (4) Fertilizer. Sales to farmers of fertilizer are exempt from tax provided that such fertilizer is used directly in farming.
- (5) Fungicides and insecticides. Sales to farmers of fungicides and insecticides are exempt from tax provided such items are used directly in farming.
- (6) Sales to farmers of tangible personal property used to groom or treat poultry and animals used in the production of food, so as to preserve their health, (including property such as medicines, serums, dehorers, debeakers, hoof trimmers [sic.] hormones for productive animals, inoculation needles, and syringes) are exempt from tax.

(d) Non-exempt purchases:

- (1) Other tangible personal property. Sales to farmers of other tangible personal property are taxable unless the property is used in direct production of food or agricultural commodities.
 - (2) Sales of beds, mattresses, kitchen equipment, recreation items, etc., used in conjunction with the operation of migrant labor camps are taxable. Such items are not used directly in farming.
 - (3) Sales to farmers of property to be incorporated into real estate in such a manner as to become part of the real estate are taxable. If the unit is directly used for manufacture or a process of manufacture, it is to be considered as personal property.
 - (4) Materials purchased for use in construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance, or improvement of farm buildings incorporated into realty are taxable.
 - (5) Purchases of fences, fencing material, gates, posts, fence stretchers, and electric fence chargers are taxable.
 - (6) Purchases of watering tubs and troughs and tile for drainage are taxable.
 - (7) Tangible personal property purchased by a farmer for use in general farm maintenance of taxable items is taxable.
 - (8) Sales to farmers of tangible personal property to be used in managerial, sales, or other farm activities not directly related to the production of food are taxable. 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.
 - (9) Buildings which only protect the animals from adverse weather conditions are taxable.
- (e) Exempt Purchases: (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. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces food or agricultural commodities.
- (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.

(3) Fences, fencing materials, gates, posts, and electric fence chargers (listed in [45 IAC 2.2-5-3\(d\)\(6\)](#) and [2.2-5-4\(c\)](#) [[45 IAC 2.2-5-4\(c\)](#)]) are exempt only if the same are purchased for use in confining livestock during the production processes of breeding, gestation, farrowing, calving, nursing, or finishing. Fencing materials are taxable if the fence is used to confine horses, ponies, donkeys, or pets not used in agricultural production. Fencing materials are also taxable if the fence is used only as a partition fence between adjoining landowners or as a means to keep wildlife, stray animals, or trespassers from entering cropland or farm premises.

(4) Purchases of feeding and watering equipment.

(Emphasis added).

[45 IAC 2.2-5-4\(e\)](#) states:

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.

There is no question that Taxpayer is a farmer engaged in the direct production of food or agricultural commodities and is entitled to claim the exemption for equipment directly involved in the direct production of that personal property. The issue is whether the load chute is directly used in Taxpayer's direct production process.

Taxpayer argues that the load chute is an integral and essential part of its production process. Taxpayer argues that it is in the business of producing hog carcasses, not live hogs. Taxpayer explains that it "purchases 12-15 lb. pigs to grow into 230-280 lb. pigs for the purpose of selling lean hog carcasses for profit." Therefore, Taxpayer protests, the load chute is used to unload the piglets that arrive at the farm where they are sorted by size and grade, and then later used to load the market-ready pigs onto the trucks that take the pigs to the slaughterhouse. Taxpayer argues that its production process begins with the unloading of the pigs and ends after the animals are slaughtered.

Unloading the piglets – using the chute - from trucks that transported the piglets to the farm is not an activity directly within the Taxpayer's direct production process. [45 IAC 2.2-5-3\(d\)\(8\)](#).

The remaining question then is when Taxpayer's process ends thus determining the termination of the exempt activities. Taxpayer states that his process ends after the pigs are slaughtered at the slaughterhouse. Taxpayer stated that it pays the slaughterhouse. Taxpayer also offered as evidence documents from a purchaser valuing the carcasses based on certain categories and criteria and showing adjustments to an account. Taxpayer stated that it was paid based on these documents. It should be noted that neither of these documents is complete since portions of the documents were either obscured or left out when they were copied for presentation at the hearing. At the hearing Taxpayer was asked for additional documentation such as invoices for its payments to the slaughterhouse, agreements, contracts, bills, etc.

Taxpayer stated at the hearing that the processing fee is taken into account in the price offered to the hog farmer by the purchaser and that there were no invoices, contracts, or agreements. The fact that the purchaser subtracts out the processing fee when it values the carcasses for which it is paying raises the implication that the purchaser is paying for the processing, not Taxpayer.

The Department presumed that Taxpayer was in the business of raising market-ready pigs. The Department therefore did not exempt the use of the chute and associated hardware because they were used after the direct production process had ended; i.e., after Taxpayer's pigs were market-ready. Additionally, [45 IAC 2.2-5-3\(d\)\(8\)](#) specifically states that transportation of animals from the farm to market is not an exempt activity. Certainly, Taxpayer's use of the chute may be necessary to its operation but that does not mean that the chute qualifies for exemption from sales and use tax. [45 IAC 2.2-5-4\(e\)](#).

Given all of the above, Taxpayer has not met its burden to show that the Department's presumption - that the load chute and associated hardware are not exempt and are therefore subject to use tax - is incorrect. Therefore, the load chute and associated hardware are subject to use tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Imposition of Negligence Penalty.

DISCUSSION

The Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

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 standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

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.

Taxpayer has affirmatively established, as required by [45 IAC 15-11-2\(c\)](#), that its failure to pay sales tax on the transactions relating to the load chute was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer's use of the load chute and associated hardware does not qualify for exemption from use tax; but the ten-percent negligence penalty is waived.

Posted: 09/28/2011 by Legislative Services Agency

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