DEPARTMENT OF STATE REVENUE

04-20100710.LOF
04-20100712.LOF

Letters of Findings: 04-20100710 and 04-20100712
Sales and Use Tax
For the Tax Years 2007, 2008, and 2009

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ISSUES

I. Sales and Use Tax–Public Transportation Exemption.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-27; 45 IAC 2.2-5-61; State Dep't of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App. 1979); National Serv-All, Inc. v. Indiana Dep't of State Revenue, 644 N.E.2d 954 (Ind. Tax Ct. 1994); Indiana Waste Systems of Indiana, Inc. v. Indiana Dep't of State Revenue, 644 N.E.2d 960 (Ind. Tax Ct. 1994); Panhandle Eastern Pipeline Co. v. Indiana Dep't of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001); Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005); Indiana Dep't of State Revenue v. Kimball Int'l, 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer protests the imposition of use tax on a variety of purchases.

II. Tax Administration–Negligence Penalty.

Authority: 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 is an Indiana business organized as a sole proprietorship for the 2007 and 2008 tax years and as a single member LLC for the 2009 tax year. Taxpayer's business operations include: (1) purchasing "cull lumber" and "cants" (the center cut of logs) from sawmills and reselling the lumber and cants including delivery of the lumber and cants to the customers; (2) purchasing already timbered logs, transporting the logs to third parties to have the logs cut into cants, and then reselling the cants including delivery of the cants to the customers; (3) purchasing sawdust from saw mills and reselling the sawdust including delivery of the sawdust to the customers; and (4) hauling various items for sawmills, which during the audit Taxpayer estimated was ten percent of their income.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the 2007, 2008, and 2009 tax years. The Department's audit found that Taxpayer had neither paid sales tax nor remitted use tax on certain of its purchases including repair parts, tires, and fuel. The Department assessed Taxpayer additional use tax, penalty, and interest. Taxpayer protested the assessment of tax and penalty on the basis that certain of its purchases qualified for the public transportation exemption. A hearing was held, and this Letter of Findings ensues. Further facts will be supplied as necessary.

I. Sales and Use Tax–Public Transportation Exemption.

DISCUSSION

As a threshold issue, it is the 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."

Indiana imposes "an excise tax, known as the use tax," on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a). An exemption from the use tax is granted for transactions when sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. The Department's audit found that Taxpayer purchased items including repair parts, tires, and fuel, etc., without paying sales tax at the time of purchase. Since Taxpayer failed to pay sales tax on the items at the time of purchase, the Department assessed use tax on the purchases.

Taxpayer asserts that certain of the purchases are not subject to use tax. Taxpayer maintains that the Department incorrectly assessed use tax because it is entitled to the "public transportation" exemption. The exemption sought is found at IC § 6-2.5-5-27, which provides:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

45 IAC 2.2-5-61 elaborates on the public transportation exemption. The regulation states in relevant part:

> (a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.
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> (b) Definition: Public Transportation. Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier,

household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the transportation of persons or property for consideration as defined above.

(c) In order to qualify for exemption, the tangible personal property must be reasonably necessary to the rendering of public transportation. The tangible personal property must be indispensable and essential in directly transporting persons or property.

Indiana courts have interpreted the public transportation exemption in a series of cases including State Dep't of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App. 1979) (holding that the tangible personal property being transported must be the property of another); National Serv-All, Inc. v. Indiana Dep't of State Revenue, 644 N.E.2d 954 (Ind. Tax Ct. 1994) (holding that to be entitled to the public transportation exemption, a carrier must transport tangible personal property of another and for consideration); Indiana Waste Systems of Indiana, Inc. v. Indiana Dep't of State Revenue, 644 N.E.2d 960 (Ind. Tax Ct. 1994) (holding that a taxpayer must use the tangible personal property predominately in public transportation in order to qualify for the exemption); Panhandle Eastern Pipeline Co. v. Indiana Dep't of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001) (holding that the public transportation predominant use exemption is an all or nothing exemption); Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005) (holding that it is the predominant use of the property that determines whether a taxpayer, involved in multiple lines of business, is entitled to the public transportation exemption, and not whether a taxpayer, as an overall business, is predominately engaged in public transportation).

In summary, in order to qualify for the public transportation exemption, Taxpayer must show that the equipment purchased was predominantly used to transport the property of another for which the Taxpayer received consideration.

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer maintains that its transportation equipment purchases, which included repair parts, tires, and fuel, qualify for the public transportation exemption. During the course of the protest, Taxpayer provided a "mileage summary," which listed mileage of drivers as either "Taxpayer mileage" or "for-hire mileage," and fifteen invoices for customers whose mileage was included in the "for-hire mileage" category to demonstrate that Taxpayer operated transportation equipment to transport property of a third party for consideration.

Notwithstanding that Taxpayer's documentation failed to indicate on which piece of its transportation equipment its purchases of repairs, fuels, and other items were used, Taxpayer's documentation was also insufficient to establish that Taxpayer's equipment purchases were predominantly used to transport the property of another for consideration. In fact, fourteen of the fifteen customer invoices that Taxpayer submitted for the "for-hire mileage" customers did not include transportation charges, but reflected line items for the logs, chips, lumber, or other items of tangible personal property being sold. In these situations when Taxpayer delivers the logs, lumber, and chips that Taxpayer has purchased and resold to its customers, Taxpayer is hauling its own products. As explained in Carnahan Grain, the public transportation exemption applies only to entities hauling the property of others for consideration. Therefore, since the documentation submitted was insufficient to establish that Taxpayer's transportation equipment purchases were predominantly used in transporting the property of another for consideration, Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest of the assessment of use tax is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

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.

In this case, Taxpayer incurred a deficiency 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 not sufficiently established that its failure to pay the tax was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest of the assessment of the negligence penalty is denied.

CONCLUSION

Taxpayer's protest is denied.

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