

Letter of Findings Number: 04-20120731
Use Tax
For Tax Years 2009-11

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ISSUES

I. Use Tax—Imposition.

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

Taxpayer protests the imposition of use tax.

II. Tax Administration—Negligence Penalty.

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

Taxpayer protests the imposition of ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturer. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on some taxable items at the time of purchase during the audit years of 2009, 2010, and 2011. The Department therefore issued proposed assessments for use tax, penalties, and interest for those years. Taxpayer protested the imposition of a portion of the use tax and the imposition of penalties. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Imposition.

DISCUSSION

Taxpayer protests a portion of the Department's proposed assessments of use tax for the tax years 2009-11. The Department based its determination of the amount of use tax due on a sample and projection calculation of Taxpayer's ordinary purchases and on an item-by-item review of Taxpayer's capital purchases. The Department reviewed the purchases and imposed use tax on items of tangible personal property ("TPP") upon which sales tax had not been paid at the time of purchase. Taxpayer protests that some of the items listed as taxable were actually exempt from sales and use tax. 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).

Sales tax is imposed by IC § 6-2.5-2-1, which states:

(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.

(Emphasis added).

Use tax is imposed under IC § 6-2.5-3-2(a), which states:

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.

[45 IAC 2.2-3-4](#) further explains:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction.

Also of relevance is IC § 6-2.5-5-3(b), which states:

Except as provided in subsection (c), transactions 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.

Also, IC § 6-2.5-5-4, provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

[45 IAC 2.2-5-8](#) elaborates in relevant part:

(a) In general, all purchases of tangible personal property by persons engaged in the direct production,

manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [45 IAC 2.2] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

45 IAC 2.2-5-8(f)(3), states as an example:

Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

Therefore, there is an exemption from the sales and use taxes if the tangible personal property in question is directly used in the direct production of a taxpayer's product. This is known as the "double direct" test.

The first category of items under protest includes some, but not all, of the items included in the sample and projection calculations as taxable. The Department used a sample of Taxpayer's purchases and reviewed those purchases to determine if Taxpayer had any taxable purchases upon which sales tax had not been paid at the time of purchase. The Department then determined a percentage of those purchases upon which use tax was due ("Compliance Percentage") and applied that percentage via a projection method to Taxpayer's total purchases for all three audit years. Taxpayer states that some of the items included as taxable in the Department's calculations were actually exempt and that the resulting percentage of use tax due was too high.

After review of the items under protest in this category, the Department agrees that most of those items are not subject to use tax. However, the Department is not convinced that all of the items listed by Taxpayer should be removed from the projection calculations. Specifically, the two purchases found at Strata 6 Sort 91 and Strata 6 Sort 122 were bin layer systems which Taxpayer states were shipped out of state. Taxpayer states that, since the two purchases were equipment which was shipped out of state they should be exempt from sales and use tax. A review of the documentation supplied in the protest process shows only that the two purchases were billed to Taxpayer's Indiana address. Taxpayer provided a tool room log and pictures of the items in question but was unable to provide shipping documentation. The documentation provided does not establish that the purchases were shipped out of state. Neither do the pictures establish that the items in question were used during the production process. Taxpayer has not met the burden of proving these portions of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

Therefore, all items listed by Taxpayer as non-taxable in the sample and projection sample population except the two purchases found at Strata 6 Sort 91 and Strata 6 Sort 122 will be reclassified as non-taxable and the Compliance Percentage will be recalculated. Once the Compliance percentage is recalculated, it will be applied to Taxpayer's total purchases to determine use tax due for the three audit years.

The second category of items under protest consists of capital assets upon which the Department determined that use tax was due. Taxpayer protests that one of these items did have sales tax paid at the time of purchase. During the protest process, Taxpayer supplied the relevant invoice which does show that sales tax was paid at the time of purchase. Use tax is therefore not due on this purchase. Also, Taxpayer states that a data entry error on page 16 of the audit report incorrectly listed a particular purchase as \$261,510.00 when the actual amount of the purchase was \$2,651.10. Taxpayer supplied the relevant invoice which confirms that the amount of the purchase was \$2,651.10.

Taxpayer also states that one purchase (reference number 31877) was for production equipment which was shipped out of state to other facilities. As explained above, the documentation does not establish that the equipment was shipped out of Indiana. Neither does the documentation establish that the equipment was directly used in the direct production of tangible personal property, as required by IC § 6-2.5-5-3(b). Also, Taxpayer states that a vacuum system is used fifty percent to pull raw materials out of storage and fifty percent to move work-in-process. The supplied documentation does not establish this percentage, therefore Taxpayer has not established that the vacuum system meets the requirements of IC § 6-2.5-5-3(b).

Therefore, Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) regarding all capital expense items listed as non-taxable in its protest with the exception of the purchase under reference number 31877 and the vacuum system. Taxpayer did not meet the burden of proving the proposed assessments wrong with regards to those two items. The Department will change the data entry error to show the correct amount of \$2,651.10.

In conclusion, Taxpayer is sustained regarding the items listed as taxable in the Department's sample and projection calculations with the exception of the two purchases found at Strata 6 Sort 91 and Strata 6 Sort 122. The Department will reclassify the remaining protested transactions as non-taxable, will recalculate the compliance percentage, and will reapply the resulting percentage to Taxpayer's total transactions for the three tax years at issue. Taxpayer is sustained regarding the capital asset purchases with the exception of the purchase under reference number 31877 and the vacuum system. The Department will reclassify the remaining items as not subject to use tax. The Department will perform these adjustments via a supplemental audit.

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and ten percent negligence penalties for the tax years in

question. Taxpayer protests the imposition of penalty. Taxpayer states that it underwent a major expansion during the audit years and that its compliance rate was over eighty percent during the three years at issue. Taxpayer therefore believes that it acted in a reasonable manner and that the penalties should be waived.

The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) 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.

[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.

In this case, Taxpayer incurred assessments which the Department determined were due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to penalties under IC § 6-8.1-10-2.1(a). While Taxpayer was sustained in part in Issue I above, there are significant amounts of remaining use tax due. Therefore, the negligence penalty was properly imposed. Again, the Department may not waive interest. However, since Taxpayer was partially sustained in Issue I above, penalty will be recalculated after the Department's recalculation of base tax.

FINDING

Taxpayer's protest is denied.

SUMMARY

Taxpayer is sustained in part and denied in part in Issue I regarding the imposition of use tax. Taxpayer is denied regarding the imposition of penalties for the years at issue. The Department will conduct a supplemental audit to recalculate base tax and penalty.

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