

DEPARTMENT OF STATE REVENUE

04-21060013.LOF

Letter of Findings Number: 04-20160013
Use Tax
For Tax Years 2012-13

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Business was not responsible for paying sales or use tax on certain protested items. Use tax was therefore not due on the protested items during the audit years.

ISSUE

I. Use Tax—Agricultural Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-2; IC § 6-8.1-5-1; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Graham Creek Farms v. Ind. Dept' of State Revenue, 819 N.E.2d 151 (Ind. Tax 2004); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-6](#); [45 IAC 2.2-5-7](#).

Taxpayer protests the imposition of sales tax on certain items used in agricultural production.

STATEMENT OF FACTS

Taxpayer is an Indiana grain dealer which operates grain elevators. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on certain taxable purchases during the 2012 and 2013 tax years. The Department therefore issued proposed assessments for use tax, penalty, and interest for those years. Taxpayer protested that some of the purchases were used in agricultural production and were therefore not subject to sales or use taxes. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Agricultural Exemption.

DISCUSSION

Taxpayer protests the imposition of use tax on certain purchases of tangible personal property made during the 2012-13 tax years. The Department imposed use tax on the basis that Taxpayer had purchased tangible personal property ("TPP") which it subsequently used in Indiana without paying sales tax at the time of purchase. Taxpayer protests that the TPP in question was used in the production of agricultural goods and was therefore eligible for the agricultural exemption from sales and use taxes. Specifically, Taxpayer protests the imposition of use tax on TPP used in a grain-drying process.

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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing. . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

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).

Therefore, retail merchants are required to collect sales tax on retail transactions, unless the transaction is exempt from sales tax.

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 sales tax is not paid at the time TPP is purchased, use tax will be imposed unless the purchase is eligible for an exemption.

Of relevance is IC § 6-2.5-5-2, which 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.
- (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 he 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.(Emphasis added).

Also, [45 IAC 2.2-5-6](#) states in relevant parts:

- (a) In general, all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable. (The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to agricultural machinery, tools, and equipment.)
- (b) The state gross retail tax shall not apply to sales of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing or [sic.] agricultural commodities.
- (c) Purchasers of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing of agricultural commodities are exempt from tax provided such machinery, tools, and equipment have a direct effect upon the agricultural commodities produced, harvested, etc. Property is directly used in the direct production, extraction, harvesting, or processing of agricultural commodities if the property in question 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, i.e. confinement buildings, cooling, heating, and ventilation equipment. The fact that such machinery, tools, or equipment may not touch the commodity or livestock or, by itself, cause a change in the product, is not determinative. . . . (Emphasis added).

Also, [45 IAC 2.2-5-7](#) provides in relevant parts:

(a) Agricultural machinery, tools, and equipment directly used in the direct production, extraction, harvesting, or processing of grain, from the time the grain is harvested until the time the grain is dried, are exempt so long as the agricultural machinery, tools, and equipment have an immediate effect upon the grain. Property has an immediate effect on the grain being produced if it is an essential and integral part of an integrated process which produces grain.

...

(d) Grain drying bins. The department has determined that grain drying accessories of a grain drying bin are exempt, since such equipment is used to dry wet grain and, therefore, has a direct and immediate effect upon grain. Alternatively, the department has determined that a grain drying bin's storage structure and parts thereof are subject to tax, since the storage of grain has no direct and immediate effect upon grain.

(1) The following is a list of grain drying bin accessories which are exempt from tax:

- (A) drying floor;
- (B) air entrance;
- (C) stirring devices;
- (D) fans and motor running fans;
- (E) electricity (if predominantly used);
- (F) electrical control panels;
- (G) spreader; and
- (H) floor supports.

(2) The following is a partial list of grain drying bin storage accessories which are subject to tax:

- (A) anchor bolts;
- (B) bin structure;
- (C) roof and vents;
- (D) unloading auger;
- (E) clean sweep;
- (F) wells and pulleys;
- (G) platform; and
- (H) ladders.

Also of relevance is the Indiana Tax Court's opinion in *Graham Creek Farms v. Ind. Dept' of State Revenue*, 819 N.E.2d 151 (Ind. Tax 2004). In that case, the taxpayer made upgrades to a tobacco drying barn and the Department determined that there was no active role played by the barn or any equipment in the barn and so the barn and the equipment did not affect the production of the agricultural product. The court explained:

The tobacco barn has roof vents for ventilation and specially designed shutters along the sidewalls that can be adjusted to direct the air flow in and out of the barn. Corya testified that if the sticks with the tobacco stalks were not hung on the rails correctly spaced apart (thereby not receiving the proper airflow) they would rot immediately (a condition known as "house burn"). Consequently, Graham asserts that the materials and labor charges it paid to construct its tobacco barn are exempt because the tobacco barn is integral and essential to the process of producing marketable tobacco. See [45 IAC 2.2-5-6\(b\)](#) (exempting agricultural equipment used in "the direct production ... [of] agricultural commodities")

The Department claims that the tobacco barn is not essential to the process of producing tobacco. Specifically, it asserts that "[t]he drying of the tobacco was not actively induced by the tobacco barn but was merely incidental to the proper storage of the tobacco." Therefore, the Department argues that because the drying process is passive, the tobacco barn does not directly affect the tobacco and is not part of the production process.

The evidence demonstrates that in the tobacco drying process, the proper circulation of air is essential to avoid "house burn." **Marketable tobacco is not produced until an eighty-pound stick of tobacco stalks is dried and essentially reduced to one and a half pounds of marketable tobacco. Clearly, the drying process has a direct effect on transforming unmarketable tobacco stalks into marketable tobacco; without the tobacco barn's effect, the tobacco stalks would rot and no marketable product would be produced.** See e.g., *Gen. Motors Corp. v. Indiana Dep't of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct.1991) (determining that production ended when taxpayer placed products in their most marketable form), *aff'd*, 599 N.E.2d 588 (Ind.1992). **Accordingly, the Court concludes that the tobacco barn is integral and essential to the production process of producing marketable tobacco, and Graham is entitled for an exemption for the materials purchased to remodel its tobacco barn.**

Id. at 158-59. (Internal notations omitted)(Emphasis in original)(**Emphasis added**).

Therefore, when the taxpayer in Graham Creek Farms purchased materials to remodel a barn that dried tobacco passively, the court determined that the barn did not have to actively dry the agricultural product in order to qualify for the exemption provided under IC § 6-2.5-5-2 and [45 IAC 2.2-5-6\(b\)](#). In the instant case, the Department determined that the bin did not have a burner and so was not actively drying the grain but rather was acting as a storage and aeration building. Since storage and aeration buildings and equipment are not exempt, the Department imposed use tax on the materials used to construct the bin.

In the course of its business, Taxpayer purchased the TPP which is the subject of this protest as parts for a grain drying bin. Taxpayer states that the bin is not merely for storage or aeration of the grain. In the course of the protest process, Taxpayer was able to demonstrate through documentation and analysis that the bin and its component parts constitute an integrated drying process, similar to the tobacco barn discussed in Graham Creek Farms. Also, the grain is rotated in, dried, and rotated out on an ongoing basis. Taxpayer explained that there are eleven different extraction points to allow grain of different moisture levels to be withdrawn from the process depending on the customer's requirements. In other words, new grain is being fed in at the beginning of the agricultural production process and is removed at the end of the agricultural production process. The activities within the bin are wholly drying activities and not storage activities. Therefore, Taxpayer has established that under IC § 6-2.5-5-2 and [45 IAC 2.2-5-6\(b\)](#) the parts purchased for the grain-drying bin and integrated drying system are exempt from sales and use taxes.

Similarly, Taxpayer states that the "legs" used to transport the grain within the grain-drying operation are exempt as part of an integrated agricultural product process. The Department considered the legs to constitute pre-production equipment and so the TPP purchased to construct them was taxable. The court in Graham Creek Farms addressed this subject when it wrote:

Graham claims that items such as paint, stone, and mineral spirits used to maintain the grain leg of its grain handling operation are exempt. **The grain leg is the portion of the grain-drying operation that lifts the grain to the top of the tower where it is cleaned both at the time it goes into the grain bin and then again out of the bin for transport.** Corya explained that the paint and mineral spirits were used to repair portions of the grain leg that had rusted and were no longer painted. The stone was used to create a drive where trucks could pull up to be loaded under the grain spout.

Graham asserts "the grain leg and the driveway to the grain system are integral and essential to the processing of the grain and are therefore exempt." The Department claims that the paint, stone, and mineral spirits do not qualify for exemption because they "do not have an immediate effect upon the grain."

The Department's regulations support Graham's contention that the grain leg itself is an essential part of the process of producing marketable grain. See [45 IAC 2.2-5-7\(d\)](#) ("grain drying accessories of a grain drying bin are exempt, since such equipment is used to dry wet grain and, therefore, has a direct and immediate effect upon grain"). Nonetheless, the materials used to maintain the grain leg are not exempt because no evidence was presented demonstrating how the materials were used in the grain drying process. See [45 IAC 2.2-5-4\(d\)\(7\)](#) (exempting repair parts necessary for the servicing of exempt equipment when the items are used directly in direct production"); [45 IAC 2.2-5-6\(e\)\(3\)](#) (1992) (1996) ("[m]achinery, tools, and equipment used in general farm maintenance are taxable. The sale of ... [] sprays ... and other tools used in general cleaning and maintenances are taxable"). Similarly, the gravel used to pave the driveway is not exempt; while a driveway may be convenient for loading the stored grain into trucks, no production is occurring. See [45 IAC 2.2-5-4\(e\)](#) ("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").

Graham Creek Farms, 819 N.E.2d 151 at 159-60(Internal citations omitted)(Emphasis in original)(**Emphasis added**).

Therefore, as explained by the court in Graham Creek Farms, the legs in Taxpayer's grain-drying process are exempt from sales and use taxes as provided by [45 IAC 2.2-5-7\(d\)](#).

In conclusion, Taxpayer has met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c) regarding TPP used in constructing the grain-drying bin and other equipment used in the agricultural production process. Included in this category are the legs used to lift the grain to the top of the bin, as provided by the court in Graham Creek Farms. The Department will conduct a supplemental audit to recalculate the amount of use tax due after removing the TPP associated with the grain-drying process.

FINDING

Taxpayer's protest is sustained.

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