

DEPARTMENT OF STATE REVENUE

04-20160532.LOF

Letter of Findings Number: 04-20160532
Use Tax
For Tax Years 2014-15

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 able to produce documentation and explanation showing that certain purchases were partially eligible for the agricultural exemption. Therefore, those purchases are partially exempt.

ISSUE**I. Use Tax—Imposition.**

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 2.2-5-3](#).

Taxpayer protests the imposition of use tax on certain transactions.

STATEMENT OF FACTS

Taxpayer is an Indiana business in the poultry/egg industry. As the result of an audit, the Indiana Department of Revenue ("Department") determined that during the tax years 2014 and 2015 Taxpayer purchased some tangible personal property ("TPP") without paying sales tax at the time of purchase and without remitting use tax during the relevant year. The Department therefore issued proposed assessments for use tax, penalty, and interest for those years. Taxpayer timely protested a portion of the purchases determined to be subject to use tax. An administrative hearing was held. This Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Imposition.**DISCUSSION**

Taxpayer protests the imposition of use tax on certain purchases of TPP it made during the tax years 2014 and 2015. The Department determined that the purchases were not eligible for the agricultural exemption and therefore issued proposed assessments for use tax on those purchases. Due to the volume of purchases during the tax years, the Department and Taxpayer agreed to use a sample and projection method to determine a use tax compliance rate for the tax years. Taxpayer states that TPP purchased for use in modifying a barn for manure handling were exempt and so were not subject to use tax. Taxpayer therefore argues that the TPP should be reclassified as exempt and that the use tax compliance rate should be recalculated and reapplied to all three tax years.

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.

Use tax is imposed by 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 § 6-2.5-5-2, 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).

Therefore, if the TPP is used in the direct production, extraction, harvesting, or processing of agricultural commodities, it is exempt from sales tax under IC § 6-2.5-5-2. In this case, Taxpayer has protested the imposition of use tax on TPP used in constructing a manure building.

The Department determined that the manure building was used to store the poultry manure without any processing or treatment of the manure prior to sale. [45 IAC 2.2-5-3](#) provides:

- (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 [\[45 IAC 2.2\]](#) 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, dehorners, 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 charger (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).

In the course of the protest process, Taxpayer explained that removal of the manure from the building in which the egg layers were located resulted in improved health of the layers and so resulted in improved egg quality and quantity. Taxpayer also refers to a 2013 advisory letter from the Department to the Indiana State Poultry Association which states that a new manure barn used exclusively for the purpose of processing and handling manure would be exempt from Indiana sales tax. Therefore, Taxpayer argues, the manure building is part of an overall agricultural production process and is therefore exempt.

After review of the provisions of IC § 6-2.5-5-2(b)(3) and of [45 IAC 2.2-5-3\(c\)\(6\)](#), the Department does not agree that the manure barn qualified for the exemption since it did not directly gather, spread, or move the manure or directly affect the health of the poultry. The equipment that moved the manure from the egg-laying facility to the manure barn directly moved the manure, but the barn did not. Therefore, the barn does not qualify for the agricultural exemption on that basis. However, in the protest process Taxpayer also explained that the manure building was used to dry the manure prior to sale for fertilizer purposes. As provided by [45 IAC 2.2-5-3\(a\)](#) fertilizer is an agricultural commodity and the drying process constituted the production of an agricultural commodity.

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 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 159 (internal notations omitted)(emphasis in original)(**emphasis added**).

As provided by [45 IAC 2.2-5-3\(b\)](#), TPP used to produce agricultural commodities is exempt from sales and use taxes. Since Taxpayer used the manure barn to both store and dry the manure, and since the storing of the manure is non-exempt activity and the drying of the manure constitutes an exempt agricultural production process as explained by the court in *Graham Creek Farms*, the materials used to construct the manure barn were fifty percent exempt and fifty percent taxable.

FINDING

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

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