DEPARTMENT OF STATE REVENUE

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Supplemental Letter of Findings Number: 04-20150172
Use Tax
For Tax Years 2011-13

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 Supplemental Letter of Findings.

HOLDING

Business was able to produce documentation and explanation showing a higher exemption rate for utility usage than originally determined. Not all areas of protest were sustained. Therefore, the exemption rate will be recalculated. Waiver of penalties was not warranted.

ISSUES

I. Use Tax–Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-5.5; IC § 6-2.5-4-5; 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); 45 IAC 2.2-3-4; 45 IAC 2.2-4-13.

Taxpayer protests the imposition of use tax on utilities.

II. Tax Administration–Penalties.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

Taxpayer owns and operates a group of seven restaurants in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer did not pay sales tax on all of its taxable utility usage for the tax years 2011, 2012, and 2013. The Department therefore issued proposed assessments for use tax, penalty, and interest for those years. Taxpayer protested the imposition of use tax and penalty. An administrative hearing was scheduled but neither Taxpayer nor its representatives attended the hearing. Per Department policy, the protest was deemed withdrawn. Subsequently, Taxpayer's representative contacted the Department to request a rehearing. The Department granted the request. A supplemental hearing was held and this Supplemental Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on its purchase of utilities at seven restaurants it owned and operated during the tax years 2011, 2012 and 2013. Taxpayer had claimed and received refunds for sales tax paid on electricity purchases at three locations in 2013. Three other locations had predominant use exemptions in place for all three tax years at issue. The seventh restaurant did not have the electrical meter in the name of Taxpayer, therefore that restaurant was not eligible to claim the predominant use exemption for utilities. The review of the remaining six restaurants' utility usage resulted in the Department making several adjustments to Taxpayer's calculations of taxable electrical use and exempt electrical use. After these revisions, the Department concluded that four of the six restaurants in question did not qualify for the predominant use exemption allowed under IC § 6-2.5-4-5(c)(3) for electricity. Taxpayer protests that not all of the Department's adjustments were correct and that all six restaurants did qualify for the predominant use exemption.

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.

The next relevant statute is IC § 6-2.5-5-5.1, which states:

> (a) As used in this section, "tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat.
> (b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

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 unless an applicable exemption is available.

In the case of electrical usage, 45 IAC 2.2-4-13 explains:

> (a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to consumer is subject to tax.
> (b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling electrical energy gas, water, or steam to consumers for direct use in direct manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5 shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under IC 6-2.5-5-5.1.
> (c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5, based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.

(d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.
(e) Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses.
(Emphasis added.)

Finally, the Department refers to IC § 6-2.5-4-5(c), which states in relevant part:

Notwithstanding subsection (b), a power subsidiary or a person engaged as a public utility is not a retail merchant making a retail transaction in any of the following transactions:
. . .
(3) The power subsidiary or person sells the services or commodities listed in subsection (b) to a person for use in manufacturing, mining, production, refining, oil extraction, mineral extraction, irrigation, agriculture, or horticulture. However, this exclusion for sales of the services and commodities only applies if the services are consumed as an essential and integral part of an integrated process that produces tangible personal property and those sales are separately metered for the excepted uses listed in this subdivision, or if those sales are not separately metered but are predominately used by the purchaser for the excepted uses listed in this subdivision.

Therefore, if fifty percent or more of electricity sold from a single meter is used in an exempt manner, the taxpayer is considered to have predominantly used the electricity for exempt purposes and the electricity sold through that meter is wholly exempt from sales tax and use tax. The Department's audit determined that two of Taxpayer's restaurants did qualify for the predominant use exemption provided under IC § 6-2.5-4-5(c)(3) and so there were no proposed assessments of use tax on the purchase of electricity for those two locations. The Department determined that the remaining four restaurants did not qualify for the predominant use exemption and so recalculated the percentage of exempt use of the utilities. Of those four locations, the Department's recalculations for exempt usage rates were forty-eight percent, forty-three percent, forty-six percent, and thirty-six percent. The Department determined that the thirty-six percent exemption rate for one location was not reasonable and therefore applied an exemption rate of forty-five percent, which is an average of the other three exemption rates, to that location.

The Department based its determination that the four restaurants were not predominantly exempt on its calculations starting with the utility studies supplied by Taxpayer in its exemption application process. The Department then visited each location to verify the utility studies. During these visits, the Department noted several inconsistencies between the type, number, and nature of the equipment listed on Taxpayer's utility studies and the equipment observed on-site. Specifically, the Department noted that for each location several pieces of equipment were left off of the utility study including: televisions, menu boards, outside lighting and computer monitors, and heated sandwich holding equipment. These items are all non-production equipment and were added to the numerator of the calculation used to determine exempt and taxable utility usage. Also, items such as coolers, freezers, coffee makers, fryers, and ice machines were adjusted to reflect the accurate amount in each store. Those adjustments either increased or decreased the percentage of exempt electricity usage. Also, the Department noted that one piece of equipment was listed twice under two different names. The Department removed one of the listings.

In another adjustment, the Department noted that several items were listed as wholly used in production and were treated in Taxpayer's utility study as wholly using electricity in an exempt manner. The Department considered these items to be partially used in production and partially used in post-production warming or cooling. The Department recalculated exempt and taxable use of these items and then re-entered those amounts into the calculations of exempt and taxable utility usage. Also, the Department noted that several pieces of equipment were listed on Taxpayer's utility study as having a three-phase power supply while in fact they used a single-phase power supply. Since single-phase power equipment uses a significantly lower amount of electricity, the Department adjusted the usage numbers for these items and re-entered those amounts into the calculations of exempt and taxable utility usage. Finally, the Department determined that it was appropriate to use Department-calculated standard electrical usage figures for some pieces of equipment as determined by its experience in dealing with these types of equipment.

Taxpayer disagrees with the Department's conclusion that the four restaurants were under fifty percent exempt

usage on their electricity purchases. Taxpayer made several points of protest in support of its position. The first point of protest is that Taxpayer believes that the Department under-calculated the power consumption of several pieces of equipment used in the food production process. Specifically, Taxpayer provided photographs of the serial number plates attached to these pieces of equipment. Those plates also list power requirements including volts, wattage, hertz, and/or phase type. Not all plates had all of these categories listed. Since these are manufacturer-supplied power consumption numbers, the Department will recalculate the utility studies it performed in the course of the audit and will use these numbers where applicable in the exempt usage calculations. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

The second point of protest is the number of exempt items in each store. Taxpayer states that the Department under-estimated the number of exempt items used for food production in each store. In support of its position, Taxpayer provided photographs, power ratings, and activity logs for each piece of equipment which it believes should be included as exempt in the Department's calculations of exempt power usage.

Of the four pieces listed, the Department did not question three as qualifying for the production exemption, but did not physically count it. However, the fourth piece, a bun steamer, was specifically listed by the Department as non-exempt equipment used to keep previously cooked food warm. Taxpayer protests that the bun steamer was, in fact, used to heat food and provided supporting documentation including training instructions for using this piece of equipment. After review of this additional documentation, the Department agrees that all four pieces of equipment should be included as exempt in its calculations of exempt power usage. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

The third point of protest is the daily power consumption for certain pieces of exempt equipment. Taxpayer protests that the Department under-estimated the time the exempt equipment was in use during any given day and therefore under-estimated the amount of electricity used in an exempt manner. In support of its position, Taxpayer provided monitoring reports which showed how often the equipment in question was used during a twenty-four hour period. When coupled with the power consumption data provided on the serial number plate attached to the equipment, the total amount of power consumed by the exempt equipment can be calculated. In light of this new information, the Department agrees that the amount of power used by these pieces of equipment will be increased as determined by Taxpayer's calculations in the protest materials. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

The fourth point of protest concerns the Department's calculations of electricity used by each location's roof top units. Taxpayer protests that the Department over-stated the time per day that the roof top units were cooling and also that the Department over-stated the days per year that the air conditioning units were cooling. In support of its position, Taxpayer provided explanation that the units cycled only fifty percent of the time rather than sixty percent as determined by the Department. Also, Taxpayer explained that Indiana's climate does not require year-round cooling. By Taxpayer's estimates, no more than four months of the year require air conditioning. Taxpayer therefore believes that the total amount of electricity used by the non-production roof top units is significantly less than determined by the Department. That reduced amount of non-production electrical usage, Taxpayer argues, in turn increases the percentage of exempt electrical usage and contributes to Taxpayer's belief that it is entitled to the predominant use exemption explained by 45 IAC 2.2-4-13(e).

After review of the Department's audit calculations and of Taxpayer's argument, the Department does not agree with Taxpayer's protest on this point. The audit report explained that the roof top units were used to "Circulate Heat and AC." This means that even if the Department used Taxpayer's reasoning that air conditioning is not needed year-round, heating and general ventilation would be needed for the other portions of the year and so the roof top units would be in use year-round for combined heating/ventilation/ cooling ("HVAC") purposes. Regarding Taxpayer's argument that the roof top units only cycled fifty percent of the time rather than sixty percent of the time as determined by the Department in its audit, Taxpayer has not provided documentation establishing the cycling time for the roof top units. Therefore, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

In conclusion, Taxpayer is sustained on three points of its protest. Taxpayer is sustained on the issue of power ratings as confirmed by the manufacturer's plates on those pieces of equipment for which Taxpayer has provided photographs. Taxpayer is sustained on the issue of the number of exempt pieces of equipment as confirmed by photographs of the equipment in the restaurant. Taxpayer is sustained on the issue of the amount of power used by certain pieces of exempt production equipment as confirmed by the power usage study provided by Taxpayer during the protest process. Taxpayer is denied on the fourth point of protest regarding the amount of power used by roof top units in providing HVAC operations. Therefore, the Department will recalculate the amount of exempt

and taxable electric usage at each of the four restaurants in question using Taxpayer's data regarding power ratings, the number of pieces of equipment, and the amount of power used by those pieces of equipment for which Taxpayer has supplied usage monitoring reports. The Department's initial determinations regarding the roof top units will remain unchanged. Each restaurant will have a new, recalculated exemption percentage. Any restaurant with a new exemption percentage of fifty percent or greater will receive the one hundred percent predominant use exemption listed under 45 IAC 2.2-4-13(e). Taxpayer also requested that the restaurants have their ST-109 exemption certificates reinstated as predominantly exempt. While a Letter of Findings is not the appropriate venue for restoring exemption certificates used in refund claims, Taxpayer may use the results of this Letter of Findings and the subsequent audit recalculations of the exemption percentages in its application for ST-109s for these restaurants.

FINDING

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

II. Tax Administration–Penalties.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. 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:
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> (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 protests the Department's assessment of penalties. While Taxpayer has been partially sustained on the imposition of use tax as described in Issue I above, it is also true that there were other instances reported in the audit report where use tax was properly due. Therefore, waiver of penalties is not warranted under 45 IAC 15-11-2(c). However, penalties will be recalculated to reflect the reduced amount of use tax due after the Department performs a supplemental audit to implement the determinations in this Letter of Findings.

FINDING

Taxpayer's protest to the imposition of penalties is denied.

SUMMARY

Taxpayer's protest under Issue I regarding the imposition of use tax on utilities is sustained to the extent and subject to the Department's recalculations of exempt and taxable usage. Taxpayer's protest of the imposition of penalties under Issue II is denied.

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