

Letter of Findings: 04-20160686
Gross Retail Tax
For 2012-2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Hospital did not provide sufficient evidence that its purchases were used primarily for its not-for-profit purpose of caring and aiding patients and disabled persons. Hospital did provide sufficient evidence that sales tax assessed on purchases for its stand-alone cafes were exempt from sales tax.

ISSUES

I. Sales Tax - Not-For-Profit Organization.

Authority: IC § 6-2.5-5-25; IC § 6-2.5-5-21; IC § 6-8.1-5-1; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); [45 IAC 2.2-5-55](#).

Taxpayer argues that it was entitled to purchase a tractor and accessories without paying sales/use tax because it is a non-profit-organization.

II. Sales Tax - Food Preparation.

Authority: IC § 6-2.5-4-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-10](#); Aztec Partners, LLC v. Indiana Dep't of State Revenue, 35 N.E. 3d 320 (Ind. T.C. 2015); Indiana Sales Tax Information Bulletin 11 (November 2011).

Taxpayer protests sales tax assessed on purchases for food preparation.

III. Tax Administration—Penalty.

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

Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a not-for-profit hospital operating in Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for tax years 2012-2014. Taxpayer timely protested the assessment. An administrative hearing was held and this decision ensues. Additional facts will be supplied as needed.

I. Sales Tax - Not-For-Profit Organization.

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 Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dep't 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.

The Department assessed sales tax on several purchases by Taxpayer. The Department determined that the items assessed do not further Taxpayer's not-for-profit purpose and therefore are not exempt from sales or use tax. Taxpayer asserts that it is a not-for-profit organization and that its purchases qualify for exemption under IC § 6-2.5-5-25. Taxpayer protests purchases in the following categories are exempt from sales tax: grounds keeping, building and operations, child care development center, and food preparation. Taxpayer claims the first three items are exempt under IC § 2.5-5-25, because they further its not-for-profit purpose. In addition, Taxpayer claims that its food preparation purchases are exempt under IC § 6-2.5-5-1.

IC § 6-2.5-5-25 states:

- (a) Transactions involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service:
 - (1) is an organization described in section 21(b)(1) of this chapter;
 - (2) primarily uses the property or service to carry on or to raise money to carry on its not-for-profit purpose; and
 - (3) is not an organization operated predominantly for social purposes.

- (b) Transactions occurring after December 31, 1976, and involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service:
 - (1) is a fraternity, sorority, or student cooperative housing organization described in section 21(b)(1)(A) of this chapter; and
 - (2) uses the property or service to carry on its ordinary and usual activities and operations as a fraternity, sorority, or student cooperative housing organization.

(Emphasis added).

[45 IAC 2.2-5-55](#) states:

- (a) Sales to a qualified not-for-profit organization of tangible personal property or services used primarily in carrying out the not-for-profit purpose of the organization or in raising money for carrying on such purposes are exempt from the gross retail tax.
- (b) In order to qualify for the sales tax exemption on purchases, as a qualified not-for-profit organization, the following conditions must prevail:
 - (1) The organization must be qualified by being named or described in [IC 6-2.1-3-20](#), [IC 6-2.1-3-21](#), or [IC 6-2.1-3-22](#) which deals with fraternities, sororities, student cooperative housing organizations, etc. This includes not-for-profit organizations organized and operated exclusively for one (1) or more of the following purposes:
 - (A) Religious.
 - (B) Charitable.
 - (C) Scientific.
 - (D) Fraternal.
 - (E) Educational.
 - (F) Literary.
 - (G) Civic.
 - (2) Also included are the following specifically named not-for-profit organizations:
 - (A) Labor unions.
 - (B) Licensed hospitals.
 - (C) Churches.
 - (D) Monasteries.
 - (E) Convents.
 - (F) Cemetery associations.
 - (G) Public schools.
 - (H) Parochial schools.
 - (I) Pension trust.
 - (J) Business leagues.
 - (3) The organization is not operated predominantly for social purposes. The article purchased must be

used for the same purpose as that for which the organization is being exempted. Purchases for the private benefit of any member of the organization or for any other individual, such as meals or lodging, are not eligible for exemption. Purchases used for social purposes are never exempt.

(4) The fact that an organization is being exempted by the federal government or by the state of Indiana for income tax purposes does not necessarily mean that a purchase made by the not-for-profit organization is exempt.

(c) Purchases of tangible personal property by a qualified not-for-profit organization used to raise funds to further the exempt purpose of the organization are exempt even if the resale of such property is not subject to tax. The following are examples:

(1) A qualified religious organization purchases envelopes which are distributed to members for use in making weekly contributions to the church. The purchase of the envelopes by the church is exempt because the envelopes will be used to raise funds for the qualified not-for-profit organization.

(2) A qualified hospital purchases advertising posters to be used in a fundraising drive for the hospital. The purchase of the posters is exempt from the state gross retail tax because the posters will be used to raise funds for the qualified not-for-profit organization.

(d) Purchases of tangible personal property or services used primarily in carrying out the not-for-profit purpose of the qualified organization are exempt from tax. This exemption will not apply if such property is primarily used for a purpose other than the not-for-profit purpose of the organization. As used in this section, "primarily used in carrying out the not-for-profit purpose" means that the item or service is used more than fifty percent (50[percent]) of the time to further the organization's not-for-profit purpose. The following are examples:

(1) A religious organization acquired building materials to construct a new church. The purchase of such materials by the church is exempt since the new church will further the not-for-profit purpose of the organization. The fact that the church basement will occasionally be used for social events does not subject the purchase of construction materials to tax.

(2) A church sponsors a ski club for its teenage membership. The ski club purchases skis, boots, and poles to be used by the church ski club members on ski trips. These purchases are taxable because the skis, boots, and poles are used primarily to further the social purposes of the ski group and not the exempt purpose of the church.

(3) A fraternal lodge operated a golf club, a bowling alley, and a lounge where liquor is served. Purchases of property used in these facilities are taxable because the property is used for a purpose other than the not-for-profit fraternal purpose of the lodge. However, the purchase of ceremonial robes for use in fraternal meetings is exempt because the robes are used to further the not-for-profit purpose of the organization.

(4) Sales of meals at medical society meetings are taxable because the meals are provided for the convenience of the organization and its members. Such sales are taxable even when served in conjunction with a meeting which is furthering their not-for-profit purpose.

(e) A social organization will be deemed to exist for predominantly social purposes if more than fifty percent (50 [percent]) of its expenditures are for, or related to, social activities. Social activities include the following:

(1) Food and beverage services.

(2) Furnishing of sleeping rooms.

(3) Club rooms.

(4) Lounges.

(5) Recreational activities.

(6) Any other social activities.

(Emphasis added).

A. Grounds Keeping

Taxpayer refers to this category as "Grounds" and protests purchases utilized in maintaining or improving the grounds of Taxpayer's facilities. The purchases included snow shovels, salt spreader, a pick-up truck, a tractor with snow blade, sidewalk repairs/upgrades, parking lot curbs, and landscaping services. Taxpayer argues that all the items are used in the care and maintenance of the hospital grounds. Taxpayer admits that these items "are not used for direct patient care it is argued that the costs are part of the ongoing administration to uphold safety and health measures for the facilities in which medical services are provided." Still, Taxpayer argues that these activities further its ability to perform its not-for-profit purpose.

Under IC § 6-2.5-5-25, a taxpayer's transactions involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service primarily uses the property or service to carry on or to raise money to carry on its not-for-profit purpose. [45 IAC 2.2-5-55\(d\)](#) expands on IC § 6-2.5-5-25(d), stating that this exemption will not apply if such property is primarily used for a purpose other than the

not-for-profit purpose of the organization. As used in this section, "primarily used in carrying out the not-for-profit purpose" means that the item or service is used more than fifty percent (50[percent]) of the time to further the organization's not-for-profit purpose.

According to Taxpayer's IRS application for tax exempt status, Taxpayer's not-for-profit purpose is to "establish and aid for sick and disabled persons, and to maintain a training school for nurses." Thus, the Department cannot agree the items under the "**Grounds**" list is used to provide aid for sick and disabled persons. Nor are the items used primarily for Taxpayer's not-for-profit purpose. While the items may be necessary to maintain the building's ascetics and accessibility, the items do not cure or care for patients therefore the items are not exempt under IC § 6-2.5-5-25.

B. Building and Operational Supplies and Water Coolers

Taxpayer argues that several transactions regarding building repairs and upkeep, as well as administrative supplies are exempt under IC § 6-2.5-5-25. As Taxpayer explains, some purchased items include "repair/replace miscellaneous items such as security systems, data cables, window blinds, drinking fountains, motion sensors, door knobs, forms, water coolers, etc. These items are necessary in continuing the operations of the buildings under the not-for-profit guidelines."

As stated above, Taxpayer's not-for-profit purpose is to aid and care for patients. Furthermore, to be exempt under IC § 6-2.5-5-25 the purchased item must be used primarily for Taxpayer's not-for-profit purpose. Also, the water coolers are located in the waiting room area as means of hydration for anyone who needs it. Taxpayer has not proven that the purchased items are used primarily for the **care and aid of patients**. Thus, the transactions in question are not exempt under IC § 6-2.5-5-25.

Taxpayer also states that the cost for rental sites for charity events are also exempt as a direct cost to the ongoing administration of Taxpayer's activities. However, Taxpayer did not state what rental sites are exempt, prove that fundraising took place there, or that any fundraising was to further Taxpayer's not-for-profit purpose. Therefore, Taxpayer failed to meet its burden under IC § 6-8.1-5-1(c).

C. Utilities and Outdoor Lighting

Taxpayer rents several buildings and locations from outside sources and conducts medical services within these buildings. Taxpayer protests the sales tax assessed for the utilities. According to Taxpayer a misunderstanding occurred, resulting in the Department's belief that Taxpayer owned the building. Taxpayer provided the leases for these buildings, but the leases did not establish that the buildings were being utilized in an exempt manner. Therefore, the Department cannot exempt the protested sales tax regarding these buildings.

Taxpayer also states that several invoices were for outside lighting for walkways and parking lots which Taxpayer argues provide safety to all guests and patients. Taxpayer provided an excel spreadsheet which lists the utilities under protest and those not under protest. Taxpayer however has failed to demonstrate that the lighting of parking lot and walkways furthers its not-for-profit purpose. As stated above, just because something is important for the functionality of the business does not mean it furthers the not-for-profit purpose of the business.

D. Child Development Center

Taxpayer also offers a Child Development Center as part of its business. The center is only offered to employees and is offered to attract qualified personnel; it is a direct benefit to its employees. Taxpayer states, "Because of its integral relationship with the purpose of [Taxpayer's] not-for-profit function, providing of medical services and healthy living, the [center] is part of [Taxpayer's] ongoing network of medical services."

As stated above the Department cannot agree that the center is used primarily for Taxpayer's not-for-profit purpose. The center in no way "aids or cares for patients or disabled persons." Taxpayer's use of the center is too far removed from its primary purpose and therefore transactions regarding the center are not exempt under IC § 6-2.5-5-25.

Taxpayer has failed to provide sufficient explanation or documentation as to why its purchases are exempt from sales tax. In addition, Taxpayer failed to demonstrate that the lighting of parking lot and walkways furthers its not-for-profit purpose. In addition, Taxpayer did not show that the daycare center furthered its not-for-profit service. Therefore Taxpayer has not met its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

II. Sales Tax - Food Preparation.

Taxpayer owns and runs some stand-alone deli/café facilities. Taxpayer protests sales tax assessed on some purchases used for food preparation. IC § 6-2.5-5-5.1 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.

The Department notes that [45 IAC 2.2-5-10\(g\)](#) states:

"Have an immediate effect on the tangible personal property being processed or refined." Machinery, tools, and equipment used during processing or refining which have an immediate effect upon the tangible personal property being processed or refined are exempt from tax. Component parts of an exempt unit of machinery and equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of the manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not, of itself, mean that the property "acts upon and has an immediate effect on the tangible personal property being processed or refined". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

The Department has provided guidance on utility sales tax exemption for restaurants. Indiana Sales Tax Information Bulletin 11 (November 2011), 20111026 Ind. Reg. 045110660NRA, states in relevant part regarding exempt purchases by restaurants:

All purchases by restaurants of tangible personal property to be resold are exempt from sales tax. This exemption shall apply to all types of food, beverages, and other tangible personal property which are to be sold at retail. The purchase of tangible personal property that will act directly on the food during preparation is exempt from sales tax. (For example, a fryer or broiler would be exempt. However, a refrigerator is taxable because it serves merely as an agent in the preservation of food and does not act directly on the food during preparation). Utilities used in the production of food may also be exempt. (Emphasis added).

Furthermore, the Indiana Tax Court has provided additional guidance as to the production exemption as it relates to restaurants. In *Aztec Partners, LLC v. Indiana Dep't of State Revenue*, the LLC operated nineteen Qdoba restaurants in Indiana. 35 N.E. 3d 320, 322 (Ind. T.C. 2015). Aztec employees prepared certain food items that were ultimately combined into entrees that were served to customers; employees used food warmers, hot food cabinets, a food bar with heating/cooling systems, walk-in coolers, and chip warmers to hold and preserve the prepared food before being ordered by customer. *Id.* Aztec requested a refund of the sales tax it paid on the electricity it used to power the electrical equipment. The Tax Court stated:

"[T]here is one iron-clad rule: without production there can be no exemption." "[W]hether production is occurring depends on the factual circumstances of [each] case." *Id.* In any event, production requires a "substantial" change or transformation resulting from "an integrated series of operations [that] places tangible personal property in a form, composition, or character different from that in which it was acquired." Although "production is 'defined broadly[,] [it] 'focuses on the creation of a marketable good."

...

"With respect to food items, this Court has held that a taxpayer is entitled to the equipment exemption when its equipment is directly used to induce a substantial chemical change in the food, thereby transforming the food into a new, marketable product." The Court has also held, however, that a wholesale supplier of fruits and vegetables is engaged in production when it cleans, cuts, and packages the fruits and vegetables for resale despite the lack of a chemical change in the fruits and vegetables.

Here, the parties have stipulated that Aztec's electrical "equipment ... hold[s] food items prepared by [Aztec] that will be combined into [the] entrées that are sold by [Aztec]." Accordingly, Aztec's preparation and combination of the food items into entrées substantially changed the individual food items into new, marketable products that have a character and form different from the food items first acquired. The Court, therefore, finds that Aztec was engaged in production during the period at issue.

The Tax Court further analyzed Aztec's integrated process regarding whether it met the relevant statutory exemption.

As just mentioned, the parties stipulated that Aztec's electrical "equipment ... hold[s] food items prepared by [Aztec] that will be combined into [the] entrées that are sold by [Aztec]." The parties also stipulated that "[t]he purpose of the [electrical] equipment ... is to preserve the food items until they are combined into entrées that are sold by [Aztec]." Therefore, the uncontroverted evidence shows that Aztec engages in several steps before an entrée is completed for sale: it prepares, holds/preserves, and combines certain food items. Moreover, there is no evidence that demonstrates that Aztec sells the prepared food items separately. Accordingly, the Court finds that Aztec has an integrated production process and that, during the period at issue, the electricity that Aztec used to power its electrical equipment was consumed in that process.

...

Here, the use of electricity to preserve the food items at certain temperatures is essential and integral to Aztec's integrated production process because without it, Aztec could not produce the entrées. Accordingly, the Court finds that during the period at issue the electricity that powered the electrical equipment that held and preserved the food items was essential and integral to Aztec's integrated production process.

Id. at 325-27; (internal citation omitted).

In this instance Taxpayer provided a list and explanation of protested items used in the food preparation process. Some items included a food warmer, repair parts for its oven, and microwave. Taxpayer's explanation shows that the items are being used for food preparation. Thus, pursuant to IC § 6-2.5-4-3 and the reading of the production exemption in Aztec, the sales tax on purchases used to preserve prepared food is an integrated production process and is exempt from sales tax. Taxpayer has met its burden regarding its food preparation protest under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

III. Tax Administration—Penalty.

Taxpayer requested that the Department abate the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

[45 IAC 15-11-2](#)(b) further 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.

The Department may waive a negligence penalty when "the taxpayer affirmatively establishes that the failure . . . was due to reasonable cause and not due to negligence." [45 IAC 15-11-2\(c\)](#). 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." *Id.* The Department is mindful that "[r]easonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case." *Id.*

In this instance, Taxpayer has not demonstrated that its actions were reasonable as described in [45 IAC 15-11-2\(c\)](#). In addition, The Department's records do not reflect a good Taxpayer compliance history. Thus, Taxpayer's request for penalty abatement is denied.

FINDING

Taxpayer's protest of the negligence penalty is denied.

SUMMARY

In Issue I, Taxpayer's protest is denied. Taxpayer is sustained regarding Issue II. Taxpayer is denied regarding Issue III.

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