

**Letter of Finding Number: 04-20170294P**  
**Tax Administration: Penalty**  
**For Tax Years 2013-15**

**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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 established that it did not owe a penalty since its use tax deficiency was due to reasonable cause and not due to negligence.

### ISSUE

#### I. Tax Administration- Negligence Penalty.

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (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 15-11-2](#).

Taxpayer protests the imposition of a negligence penalty.

### STATEMENT OF FACTS

Taxpayer has manufacturing facilities in Indiana and in another state. Following a sales and use tax audit of the Indiana facility, the Indiana Department of Revenue ("Department") concluded that Taxpayer underreported the amount of use tax owed to Indiana. The Department issued a proposed assessment for tax, interest, and a negligence penalty. Taxpayer submitted a protest requesting a waiver of the penalty. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

#### I. Tax Administration- Negligence Penalty.

### DISCUSSION

As a threshold issue, it is 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.

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if a taxpayer shows that 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\(c\)](#):

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:

- (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.

The Department's audit report states that for sales tax purposes Taxpayer's "returns were found to be materially correct" and that "[n]o adjustments were identified." However, the audit report states that adjustments were made for "items where the manufacturing exemptions provided in [45 IAC 2.2-5-8](#) were improperly applied to the taxpayer's manufacturing process . . . ." Those adjustments also included, at times, credits. For example, the audit report states:

Credit was provided for taxes paid on production equipment, tools, supplies, and replacements parts for production equipment including, but not limited to, spreader arms, plugs, washers, seals, parts cleaner, etc. Machinery, tools, supplies, and equipment directly used by the purchaser in the direct[] production process, and the replacement parts for such machinery or equipment, are exempt from tax as discussed in [45 IAC 2.2-5-8\(c\)](#) and [45 IAC 2.2-5-8\(h\)](#).

Also, the audit report states that credit "was provided for gloves which are worn by employees to prevent injury during the production process" pursuant to [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#). Credit was also given "for use tax paid on labor, mowing, and travel charges." Taxpayer also was provided a credit for taxes paid on snow removal services and for taxes paid "on repair parts for a robot used in production." Taxpayer's forklifts were found to be used for both taxable and exempt activities, thus the audit report states that use tax "was assessed or credit was provided for taxes paid on the forklifts, repair parts for the forklifts, and propane consumed by the forklifts for the applicable percentage . . . ." Use tax adjustments were also made regarding Taxpayer's use of cranes. Among the other items reviewed, the audit report found that "[u]se tax was assessed on 16.67[percent] of carton labels and 50[percent] of thermal transfer labels." Additionally, various purchases such as computer hardware and software, apparel, advertising and promotional materials, among other items, were assessed use tax. The Department's basis for assessing the penalty was that Taxpayer has been audited before and that the current assessment is larger than the previous assessment. However, the audit report does not address what issues were dealt with in that prior audit, nor when that prior audit occurred.

Taxpayer, in correspondence to the Department, stated that it purchases "approximately \$75 million dollars in raw materials" and "\$12 million in production related supplies . . . ." Taxpayer also stated that its "typical capital spending on machinery and equipment is approximately \$7 million a year." Regarding the audit adjustments, Taxpayer stated that "any single error in the application of the use tax laws will create a significant adjustment when spread over 3 years" and that the Department reviewed a "significant volume of transactions and invoices" for the three year period. Taxpayer also stated that it had a "single person in the accounts payable department" that "review[ed] monthly invoices for the application of Indiana use tax." Taxpayer noted that for some of the items at issue it was a coding error—e.g., cranes in the distribution center were incorrectly given a manufacturing exemption. Taxpayer argued that it was not negligent regarding its tax reporting responsibilities, and that during the audit process the company did the following: assisted the Department with the audit; used the services of an external firm to retrieve data and pull invoices for the Department; provided plant tours "so the state could better understand how materials, supplies, and equipment was used in the production process"; and "made senior company representatives available to discuss different aspects of the production process with the state." Prospectively, Taxpayer states that it "has coordinated the findings of this audit into company policies which will

improve the use tax compliance." Taxpayer states that it "acts in good faith to comply with all the relevant sales & use tax obligations."

As previously noted, for sales tax purposes Taxpayer was found to be "materially correct" and no adjustments were made for the years at issue. For use tax, Taxpayer had a system in place for self-assessing use tax but was found in the audit report to have underreported (however, for some items Taxpayer was given a credit for taxes since no tax was due). [45 IAC 15-11-2\(c\)](#) states that reasonable cause is a "fact sensitive question." In the present case, items such as forklifts—which Taxpayer used in a tax exempt and a taxable manner in its processes—illustrate the particularized fact sensitivity of reasonable cause in the context of a negligence penalty for use tax on manufacturing equipment. After reviewing the facts, the Department finds that Taxpayer has met its burden of proof under IC § 6-8.1-5-1(c). Taxpayer has established that its use tax "deficiency was due to reasonable cause and not due to negligence" pursuant to [45 IAC 15-11-2\(c\)](#).

### FINDING

Taxpayer's protest is sustained.

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An [html](#) version of this document.