

DEPARTMENT OF STATE REVENUE

04-20170973.LOF

Letter of Findings Number: 04-20170973
Sales/Use Tax
For Tax Years 2014 - 2016

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Company established that it was entitled to the manufacturing exemptions for corn dryeration and equipment used to move work-in-progress wet corn. Company was denied on all other protested issues.

ISSUES**I. Sales/Use Tax–Equipment.**

Authority: IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-5-2; IC § 6-2.5-3-2; *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 2.2-5-1](#); [45 IAC 2.2-5-8](#); Sales Tax Information Bulletin 9 (July 2012); Sales Tax Information Bulletin 9 (November 2015).

Taxpayer protests the imposition of use tax.

II. Tax Administration–Penalties and Interest.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; IC § 6-8.1-5-1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of penalties and interest.

STATEMENT OF FACTS

Taxpayer operates as a feed dealer, feed mill, and a store and delivery service. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for the years 2014 through 2016. As a result of the audit, the Department issued proposed assessments. Taxpayer filed a protest regarding the proposed assessments. An administrative hearing was held, and this Letter of Findings ("LOF") results. Additional facts will be provided below.

I. Sales/Use Tax–Equipment.**DISCUSSION**

Taxpayer states that it "provides many services to [] local farmers" including "selling of fertilizer, chemicals, feed, seed, and animal health products." Taxpayer's protest letter states that Taxpayer is protesting "the taxability of thirty one line items in the audit report," which Taxpayer groups into the following processes: corn dryeration and feed mill ("Issue 1"); dry fertilizer material handling equipment ("Issue 2"); and dry material application equipment ("Issue 3").

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.

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, which is what is at issue in the present protest, 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 tangible personal property is purchased, use tax will be imposed unless the purchase is eligible for an exemption. The Audit Report made "no changes" regarding the sales tax portion of the audit. The proposed assessments that resulted from the audit were regarding use tax.

Indiana has agricultural exemptions for occupationally engaged farmers (See IC § 6-2.5-5-2). For the years at issue, Taxpayer did not meet the "occupationally engaged" requirements of IC § 6-2.5-5-2. In other words, Taxpayer was not itself occupationally engaged in farming (See [45 IAC 2.2-5-1](#)). However, the Audit Report did cite to the manufacturing related regulations (e.g., [45 IAC 2.2-5-8](#)). Regarding Taxpayer's business, the Audit Report states:

[T]axpayer operates as a [] feed dealer, with a feed mill, a store and delivery services. They are also an agricultural service provider spraying crops with insecticides and spreading lime, fertilizer and herbicides. They are also a [] seed dealer, and they operate a grain elevator buying and selling [various crops].

Taxpayer states that the Department's audit report "concedes" that the "Taxpayer is entitled to a manufacturing exemption for the drying of grain." The actual quotation from the Audit Report is that "the taxpayer is allowed the manufacturing sales tax exemption for drying the purchased grain to the acceptable moisture content for storage and further processing. However, the exemption only pertains to the dryer and the utilities consumed by the dryer while drying the grain."

As noted, Taxpayer's protest letter groups its protest into the following processes: corn dryeration and feed mill ("Issue 1"); dry fertilizer material handling equipment ("Issue 2"); and dry material application equipment ("Issue 3"). This LOF will examine each in turn below.

Corn Dryeration and Feed Mill:

Taxpayer states the following:

Taxpayer's grain elevator purchases local farmer's corn which is moved into an aerated hopper bottom bin wherein the grain drying process begins by the air being forced through the grain. From there the grain is moved into the dryer. The dryer partially reduces moisture content for adequate storing and is requisite for safe storage. Drying inhibits bacterial growth and degrading of the material. After the partially dried grain leaves the primary drier, it moves to the final drying bins to have unheated air forced through the grain to

complete the final removal of 2-3 percentage points of moisture thereby rendering the grain marketable in the commercial markets. Approximately half of the dried corn is stored and sold as finished product, the other half is work-in-process inventory to be transferred to the next step of the animal feed manufacturing process.

And regarding the "feed mill process," Taxpayer states:

Work in process corn that has been dried and stored in the storage grain bins is moved via auger into the mill area where it is processed by either the grinder, hammer mill mixer, roller. The grinders and rollers process the corn into a form that is more suited for animal consumption. The feed mixing plays a vital role in the feed mill process, as the efficient mixing is fundamental to the appropriate mixing of ingredients for even distribution of ingredients for balanced dietary benefit for animal health.

Subsequent to the hearing, Taxpayer sent to the Department photographs (with brief descriptions/explanations) of some of the items being protested (there are fifteen photographs, and per Taxpayer there are "thirty one line items" at issue in the protest). Regarding the feed mill, Taxpayer protests "a vertical mixer" that "moves material to the top where it falls back down and repeats the process to mix the material," a "hammer mill" mixer that "crushes aggregate grain and feed ingredient materials into smaller pieces," and a "roller mill" which is "a drum or cylinder that rolls to grind materials."

The Audit Report states:

As a grain elevator the taxpayer buys and sells various types of grain. If the purchased grain is too wet the taxpayer will dry the grain before reselling to other brokers. The taxpayer is allowed the manufacturing sales tax exemption for drying the purchased grain to the acceptable moisture content for storage and further processing. However, the exemption only pertains to the dryer and the utilities consumed by the dryer while drying the grain.

And then, citing to [45 IAC 2.2-5-8\(j\)](#), the Audit Report denies "repair and replacement parts" that Taxpayer "purchased exempt" to "repair and maintain elevator legs, a drag conveyor and various grain augers." However, [45 IAC 2.2-5-8\(h\)](#) states:

Maintenance and replacement equipment.

(1) Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

(2) *Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax.*

-EXAMPLE-

A manufacturer of sheet metal repairs and upgrades used machinery by replacing worn or broken parts and adding new elements and features available in state-of-the-art equipment. All items which become components of the upgraded machinery are exempt from tax. However, all tools and equipment used to repair or upgrade used machinery would be taxable.

(Emphasis added).

The Audit Report also found that Taxpayer had in "2014 and 2015 . . . made final capital lease payments exempt of tax for the purchase of a new grain leg." Taxpayer argues that the grain leg is exempt as work-in-progress, and cites to [45 IAC 2.2-5-8\(f\)\(3\)](#), which states:

Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

Taxpayer states that the "grain legs [] are used to move hot grain [] to grain bins for further drying." Similarly, Taxpayer argues that the "auger system" is "used to transport hot partially dried grain [] from the dryer to the grain bin wherein cooling fans complete the drying process." The Department finds that Taxpayer's corn dryeration equipment that was used to dry the grain, or was used to move *work-in-progress* wet corn (grain leg, materials bridge system/auger) is exempt, as are any repair parts for those specific systems.

Additionally, Taxpayer's protest includes a "vertical blender" that was "used to manufacture specific blends of various plant food ingredients," with "[t]hese mixed products" being "sold to customers" The Department finds that Taxpayer has not established that the vertical blender is exempt. Taxpayer has not shown that it was creating a new product rather than just the mixing together of already existing products. Thus Taxpayer's protest of the feed mill aspect of its processes is denied.

Dry Fertilizer Material Handling Equipment & Material Application Equipment:

Taxpayer protests the "process of transporting fertilizers to customer fields" and also "repair parts . . . for dry fertilizer equipment." Taxpayer argues:

Dry fertilizer material and trace minerals are removed from on-site storage by loaders and dumped into hoppers and conveyed into the vertical mixer via a belt conveyor. The blended material is loaded by a second belt conveyor into dry fertilizer tenders and transported to farmer's fields.

Taxpayer then makes a rather convoluted argument regarding the Department's Sales Tax Information Bulletin 9:

[The] *Department* acknowledged that these items are exempt in multiple Information Bulletins Section B. Examples (6) & (7). The *Department* does incorrectly change the exemption afforded under [IC 6-2.5-5-2\(a\)](#) by adding the stipulation from [IC 6-2.5-5-2\(b\)](#) that one must be occupationally engaged in the production of food or commodities for sale which only applies to the gathering, moving, or spreading of animal waste. That restriction on the exemption was not mentioned in [IC 6-2.5-5-2\(a\)](#) which exempts this equipment for *Taxpayer* as it is equipment used in the transportation of materials from an onsite location into the activities of the direct production of agricultural commodities.
(*Emphasis in the original*)

Further, Taxpayer states:

[The] Department did not place the "occupationally engaged" restriction on the activity in Example (5) of Information Bulletin No. 9. [IC 6-2.5-5-2\(a\)](#) Version b added language to specifically exempt this equipment and did not add the "occupationally engaged" language to section (a). Section B of the 2016 IB no. 9 exempted this type of equipment and further recognized the "occupationally engaged" language only applied to animal waste handling exemptions. [IC 6-2.5-5-2\(c\)](#) was added to provide clarity on the issue.

Taxpayer's argument requires an examination of two versions of the Department's Sales Tax Information Bulletin 9 (i.e., 2012 and 2015) and specifically the relevant Section B examples. With that in mind, Sales Tax Information Bulletin 9 (July 2012) 20120725 Ind. Reg. 045120427NRA, states in relevant part:

5. Corporation C is engaged in the business of selling agricultural chemicals and fertilizers to farmers. Corporation C purchases an applicator that will be used to spread the chemicals and fertilizer on its customer's fields. The purchase of the applicator is exempt from tax because the application of fertilizers and agricultural chemicals is necessary and plays a key role in the raising of crops.
6. When used by entities occupationally engaged in agricultural production, fertilizer and seed tenders are exempt because these specially outfitted trucks are used to move fertilizer and seed from *temporary* storage locations to the field where exempt items will be used as an essential and integrated part of an exempt process.
7. When used by entities occupationally engaged in agricultural production, shuttle tanks and pumps for crop protection products are exempt because these items are used during the planting process to mix and move exempt items from *temporary* locations directly to the field where they will be used as an essential and integrated part of an exempt process. In most cases, these items are carried by trucks that may have alternative uses that are taxable.

The Department revised Sales Tax Information Bulletin 9 in November of 2015 (effective January 1, 2016). The November 2015 version of the bulletin removed the "Corporation C" example. In a 2016 Letter of Findings ("LOF") the Department stated "that Example 5" in the 2012 Sales Tax Information Bulletin 9 was "incorrect" and was "not and will not be considered a valid source of information from the Indiana Department of Revenue (Letter of Findings 04-20150642 (May 27, 2016), 20160727 Ind. Reg. 045160303NRA). Additionally, the Department notes that Information Bulletins have a "DISCLAIMER" that states: "Any information that is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer." The disclaimer also states that Information Bulletins are "nontechnical assistance to the general public." The Department also notes that even if, *arguendo*, Taxpayer relied upon Example 5 in the 2012 iteration of Sales Tax Information Bulletin 9, that reliance would be limited by the scope of the example itself—which is specifically about an "applicator," while the photographs and explanation that Taxpayer provided subsequent to the hearing are of trailers, "liquid fertilizer tender," repair parts for a semi-tractor, and repair parts for "dry fertilizer tender trailer" (in the photographs

provided by Taxpayer, these are trucks that look similar to dump trucks). Also, any purported reliance on Example 5 would be further limited to the years 2014 and 2015, since the Information Bulletin was updated in November 2015 (effective January 1, 2016).

Lastly, regarding Taxpayer's IC § 6-2.5-5-2 argument. The 2004 version of the statute stated in relevant part:

- (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)*

In 2016 the statute was amended, but still had the language in (b)(2) regarding being "occupationally engaged in the production of food or commodities" In 2017, the statute was amended again, this time adding "(c)":

- (c) Transactions involving agricultural machinery or equipment, including material handling equipment purchased for the purpose of transporting materials into activities described in this subsection from an onsite location, are exempt from the state gross retail tax if the person acquiring the property:
 - (1) acquires it for the person's direct use in:
 - (A) the direct application of fertilizers, pesticides, fungicides, seeds, and other tangible personal property; or
 - (B) the direct extraction, harvesting, or processing of agricultural commodities;for consideration; and
 - (2) is occupationally engaged in providing the services described in subdivision (1) on property that is:
 - (A) owned or rented by another person occupationally engaged in agricultural production; and
 - (B) used for agricultural production.

Taxpayer lists this as the "Controlling Law," but the years at issue are before 2017, so Taxpayer is mistaken. The 2004 and 2016 versions of the IC § 6-2.5-5-2 are the controlling law for the period of Taxpayer's protest (2014-2016). Taxpayer's argument regarding these protested items is denied. Taxpayer was not "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." Taxpayer's protest is denied (items labeled as Issue 2 and 3 in Taxpayer's protest letter).

FINDING

Taxpayer's protest as it relates to corn dryeration equipment, including equipment to move work-in-progress wet corn, is sustained. Taxpayer's protest of feed mill equipment is denied. Taxpayer is also denied regarding all other issues protested.

II. Tax Administration—Penalties and Interest.

Taxpayer was assessed negligence penalties pursuant to IC § 6-8.1-10-2.1; interest was also assessed and cannot be waived pursuant to IC § 6-8.1-10-1(e). The Department notes that penalty waiver is permitted if a 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:

- (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 did not develop any argument regarding the penalty, thus Taxpayer's protest is denied pursuant to IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest of the imposition of penalties and interest is denied.

SUMMARY

Taxpayer's protest as it relates to corn dryeration equipment, including equipment to move work-in-progress wet corn, is sustained. Taxpayer's protest of feed mill equipment is denied. Taxpayer is also denied regarding all other issues protested.

May 1, 2018

Posted: 07/25/2018 by Legislative Services Agency
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