

DEPARTMENT OF STATE REVENUE

04-20181394.LOF

Letter of Findings Number: 04-20181394
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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Indiana Manufacturing Business was not entitled to abatement of negligence penalties because it failed to demonstrate that its failure to self-assess use tax was due to reasonable cause and not negligence.

ISSUE

I. Tax Administration - Negligence Penalty.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; IC § 6-2.5-5-1 ; [45 IAC 2.2-5-8](#); [45 IAC 15-11-2](#) ; Letter of Findings 04-20130594 (January 13, 2014).

STATEMENT OF FACTS

Taxpayer is an Indiana business which produces packaging materials. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's business records and tax returns for tax years 2014 through 2016. The audit found that Taxpayer failed to self-assess use tax on various purchases of supplies and capital assets because it mistakenly believed that these items were exempt from gross retail tax under the manufacturing exemption. Taxpayer was previously audited for tax years 2010, 2011, and 2012 and assessed additional use tax on various purchases. As a result of the current audit under protest, Taxpayer was assessed additional use tax, interest, and penalties. Taxpayer protests the penalty and requests waiver of the negligence penalty portion of the assessments. Taxpayer waived its right to an administrative hearing and requests a final determination based upon the documents provided with its protest submission. This Letter of Findings results. Further facts will be addressed below as necessary.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Regarding the imposition of penalty, the Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

Pursuant to IC § 6-2.5-2-1, a sales tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions generally involve the transfer of tangible personal property. IC § 6-2.5-4-1. A complementary 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. IC § 6-2.5-3-2.

An exemption from the gross retail tax exists under certain circumstances where the tangible personal property is used in manufacturing. IC § 6-2.5-5-1(b) provides:

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.

[45 IAC 2.2-5-8\(a\)](#) states the qualifying circumstances for the exemption:

In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation . . . extends only to manufacturing machinery, tools, and equipment **directly used by the purchaser in direct production**. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced. **(Emphasis added.)**

Taxpayer incorrectly exempted items and equipment not directly used in direct production. A portion of the items Taxpayer mistakenly believed were exempt include: miscellaneous items used in non-operational activities such as paper towels and janitorial supplies, floor cleaning machinery used in production areas but for a non-production purpose, light fixtures and materials to build walls used for non-production purposes, and computer software and hardware used for administrative purposes. The Department found that these items did not qualify for the manufacturing exemption and assessed additional use tax because sales tax was not paid at the time of the sales. Taxpayer does not dispute the assessment of additional tax; rather, Taxpayer asks the Department to abate the negligence penalties imposed on the audit assessment.

Regarding imposition of a negligence penalty, IC § 6-8.1-10-2.1(a) states, in relevant part:

Except as provided in [IC 6-3-4-12\(k\)](#) and [IC 6-3-4-13\(l\)](#) , a person that:

- (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;
- is subject to a penalty. **(Emphasis added).**

[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.

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. IC § 6-8.1-10-2.1(d) further provides:

If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

The standard for waiving the negligence penalty is further explained 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. (**Emphasis added**).

Taxpayer states that it has an established record of self-assessing and paying use tax monthly; however, Taxpayer mistakenly concluded certain items were exempt after prior notice of similar deficiencies by the Department after a prior audit for tax years 2010, 2011, and 2012. Taxpayer was previously notified of its failure to remit use tax on certain items it believed were exempt during their audit for tax years 2010, 2011, 2012. Taxpayer protested the imposition of interest on the previous audit assessment, and assured the Department that it had "instituted practices designed to mitigate further errors." Letter of Findings 04-20130594 (January 13, 2014), 20140326 Ind. Reg. 045140090NRA. However, during Taxpayer's audit for tax years 2014, 2015, and 2016, the Department concluded that Taxpayer once again failed to self-assess use tax on similar non-exempt purchases.

After review of the documentation and analysis provided in the protest process, the Department finds Taxpayer has not demonstrated its failure to self-assess and pay use tax was due to reasonable cause. Therefore, considering the particular facts and circumstances of this protest, the Department finds that waiver of penalties is not warranted.

FINDING

Taxpayer's protest is respectfully denied.

July 13, 2018

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