INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: Access to Third Party Property
Identification Number: W-0043
Date Originally Effective: October 19, 2000
Dates Revised: None
Other Policies Repealed or Amended: None
Brief Description of Subject Matter: This document will address off-site access issues when a spill or release from an underground storage tank may have migrated onto real property that is owned or operated by a person or entity that does not own or operate the site where the spill or release occurred.
Citations Affected: IC 13-23, P.L.129-2000, 328 IAC 1-3-5

This nonrule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM thirty days after presentation to the appropriate board and after it is made available to public inspection and comment, pursuant to IC 13-14-1-11.5. If the nonrule policy is presented to more than one board, it will be effective thirty days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

Access to Third Party Property

Indiana Code 13-23 requires the owners or operators of underground storage tanks (USTs) to comply with specific regulations for investigating and remediating the release of petroleum or other regulated substances. When releases occur, the owners and operators ("responsible parties") have an obligation under IC 13-23-13 to investigate the extent of the release and to undertake corrective action. Frequently, by the time the release has been discovered, the contaminants have migrated off of the property where the USTs are located. In order to conduct a complete investigation and corrective action, the responsible party may have to secure access to areas where the contaminants may have migrated, even those areas that may not be controlled or owned by the responsible party.

P.L.129-2000 requires IDEM to develop this nonrule policy document to address the following issues, which frequently arise when contamination has moved onto a third party's property:

(1) The need for a responsible party to undertake a reasonable, good faith effort to obtain access to off-site property that may be impacted by a petroleum release or spill;
(2) When IDEM may issue an order granting a responsible party off-site access;
(3) IDEM's subsequent exercise of its enforcement discretion in pursuing an action against a responsible party for failing to determine the extent of off-site contamination; and
(4) When the Excess Liability Trust Fund (ELTF) may approve reimbursement of the costs of a responsible party's investigation and remediation efforts, including an initial site characterization and corrective action plan, when off-site contamination has not been fully delineated because of a lack of off-site access.

Reasonable, good faith efforts

If necessary to complete the investigation or to implement corrective action, the responsible party must make reasonable, good faith efforts to obtain access to an off-site property. Indications of reasonable, good faith efforts include:

(1) Requests for temporary license for the responsible party and its agents and contractors, to enter upon off-site property to perform, until completed, the necessary environmental investigation and remediation activities, shall consist of at least one verbal and one written attempt to obtain access. If more attempts are made, the responsible party should keep a record of those attempts.
(2) At a minimum, requests for access should include assurances that the property will be restored to its previous condition consistent with completion of the investigation or corrective action activities and that the responsible party shall use reasonable efforts to minimize disruption to use of the off-site property.
(3) Written requests for access, which contain overly broad release, indemnification or "hold harmless" language are not considered "good faith" efforts. Instead, "good faith" efforts include a responsible party's written commitment to be responsible for damages arising from the environmental investigation and remediation work performed by the responsible parties.
(4) Requests for access should ensure that all technical data collected during the investigation on the third party property will be provided to the third party, at the third party's request.

Issuance of Order

IDEM has the authority, under IC 13-23-13-12, to require an off-site property owner to grant IDEM access to any property where "a regulated substance may be present due to a release from an underground storage tank" for purposes of investigating or remediating a release. IDEM may issue an administrative order for this purpose to the unwilling off-site property owner. IDEM will use this authority when the responsible party has made reasonable, good faith efforts to obtain access and one of the following conditions is present;

(1) The responsible party has been unable to obtain access to off-site property which IDEM has a reasonable belief has been impacted by a release from the responsible party's UST;
(2) IDEM and the responsible party have been unable to agree upon an alternative location for the investigatory or remedial work;
(3) There is no other reasonable investigation and/or remedial method available to address the off-site contamination, which does not require access; or
(4) There is an imminent threat to human health or the environment.

Enforcement Discretion

IDEM may use its enforcement discretion in determining whether to pursue enforcement against a responsible party who has been unable to comply with the requirements of IC 13-23 or any rules promulgated thereunder because of a failure to obtain the necessary off-site access. IDEM's policy is to forego enforcement against responsible parties whom, despite reasonable, good faith efforts (as defined above), are unable to obtain off-site access. IDEM will, however, bring an enforcement action if the responsible party fails to make reasonable, good faith efforts (as defined above) to obtain access or fails to explore reasonable investigation and remedial alternatives that do not require off-site access and, as a result, the investigation and corrective action cannot be completed in a timely fashion. If all of the following conditions are met, IDEM will not bring an enforcement action against the responsible party when:

(1) Reasonable, good faith efforts by the responsible party were made to obtain the necessary off-site access;
(2) The responsible party has proceeded with the investigation or corrective action to the extent reasonably possible;
(3) The responsible party has explored other reasonable options available for completion of the investigation and/or the corrective action despite the lack of off-site access; and,
(4) An administrative order has been issued granting the responsible party access to the off-site property and for a sufficient duration to allow the responsible party to complete the necessary investigation and/or remedial activities. If the responsible party fails to utilize the order to undertake the necessary investigation and/or remedial activities in a timely manner, then such an enforcement action may be pursued by IDEM against the responsible party.

Reimbursement from the Excess Liability Trust Fund (ELTF)

For purposes of ELTF reimbursement only, when a responsible party cannot complete an investigation/corrective action because of a failure to obtain access to the off-site areas, IDEM will consider a request to grant conditional approval of an Initial Site Characterization (ISC) or Corrective Action Plan (CAP) that includes only those areas for which access is obtained. The responsible party may be eligible for reimbursement under the following conditions:

(1) The applicant meets all other eligibility requirements for reimbursement;
(2) The responsible party has adequately characterized the facility and those areas to which it has access; and
(3) The ISC and CAP are approved by IDEM.

INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: Regulatory Status of Hazardous Waste Evaporators
Identification Number: W-0045
Date Originally Effective: November 17, 2000
Dates Revised: None
Other Policies Repealed or Amended: None
Citations Affected: 329 IAC 3.1
Brief Description of Subject Matter: Indiana Department of Environmental Management guidance on the regulatory status of evaporators and guidelines for use of evaporators for treatment of Hazardous Waste under Indiana's Hazardous Waste Regulations.

This nonrule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM thirty days after presentation to the appropriate board and after it is made available to public inspection and comment, pursuant to IC 13-14-1-11.5. If the nonrule policy is presented to more than one board, it will be effective thirty days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

Use of Waste Evaporators

During the last several years the department has seen an increase in requests for information regarding the use of evaporators for the treatment of hazardous waste by generators. As used herein the term "evaporators" refers to devices that are used to intentionally evaporate a hazardous waste or constituent of a hazardous waste to the air. The term does not include sludge dryers associated with wastewater treatment tank systems permitted under the Clean Water Act or treatment units permitted under the Resource Conservation and Recovery Act. The department has on numerous occasions observed situations involving evaporation of hazardous waste in a manner which violates hazardous waste management standards. Under limited circumstances the use of certain types of evaporators by generators is allowable under the hazardous waste rules. This guidance is intended to respond to those requests from generators and address the concerns of IDEM's hazardous waste program and air program.

Indiana's Hazardous Waste regulations are codified at 329 IAC 3.1. These rules incorporate by reference, with minor exceptions, federal standards for management of hazardous waste codified at 40 CFR 260 through 270 and 273. The standards that apply to generators depend on the amount of regulated hazardous waste generated in a calendar month and the total amount accumulated at any one time. Regulatory status may vary from month to month if generation rates or accumulated quantities vary. The rules distinguish among three (3) classes of generators on this basis. The smallest and least regulated class is referred to as Conditionally Exempt Small Quantity Generators (CESQGs) and is governed by 40 CFR 261.5. The remaining two classes often referred to as Small Quantity Generators (SQGs) and Large Quantity Generators (LQGs) are governed by 40 CFR 262. Requirements for SQGs are less stringent than for LQGs. If you are uncertain of your regulatory status written guidance is available from the department or you may contact the department for regulatory assistance.

Standards for SQGs and LQGs, at 40 CFR 262.34 of the hazardous waste rules, require that generators manage their waste only in tanks, containers, containment buildings, or in some instances on drip pads. Standards for CESQGs are not written with as much specificity as to type of units or conditions. For practical purposes and to avoid violations due to releases to the environment the types of units utilized by SQGs and LQGs are the most feasible and likely units for CESQGs to use to manage their hazardous waste. The rules do not prohibit treatment by generators in these units if certain conditions are met. Generators may also treat their waste under some circumstances in totally enclosed treatment systems, elementary neutralization units, and wastewater treatment tanks which discharge a treated effluent regulated by the Clean Water Act. This document will only address the circumstances under which evaporation of hazardous waste may occur from units regulated by the hazardous waste program without obtaining a hazardous waste permit from the department.

Small and Large Quantity Generators are required to minimize releases of hazardous waste or hazardous waste constituents to the environment pursuant to 40 CFR 265. 31. The department does not consider the intentional discharge of hazardous waste or hazardous waste constituents to the environment via intentional evaporation to be consistent with this requirement. Likewise, the intentional discharge to the air is not an approved means of handling waste for Conditionally Exempt Small Quantity Generators pursuant to 40 CFR 261.5. However the department does not consider the use of evaporators for aqueous waste to be in violation of these requirements if only water is being evaporated. This would limit their use to aqueous waste that does not contain volatile hazardous constituents (VHCs) unless the VHCs are first removed by filtration or captured in some manner. Due to de minimis losses of volatile materials at a facility and the low detection limits currently possible, wastewaters often contain detectable levels of VHCs. In addition filtration devices do not remove to absolute zero. For practical purposes the department will consider a wastewater to be "only" water if it contains less than one (1) part per million VHCs.

Taking the above requirements into account, the department has determined that the only types of units that may be used for evaporation purposes by generators without permits and without violation of generator management standards would be tanks or tank systems. The tanks must be designed, operated and maintained in accordance with the applicable requirements of 40 CFR 265, Subpart J and 40 CFR 262.34 if the status of the generator is SQG or LQG. CESQGs are not required to follow these specific standards but should keep in mind the overriding requirement for all categories of generators is that hazardous waste constituents must not be intentionally released to the environment. A properly designed and operated tank system with appropriate prefiltration of VHCs or capture mechanism for VHCs should meet this requirement.

"Tank" and "Tank system are defined at 40 CFR 260.10 as follows:

"*Tank* means a stationary device, designed to contain an accumulation of hazardous waste which is constructed of primarily non-earthen materials (e.g., wood, concrete, steel, plastic) which provides structural support."

"*Tank system* means a hazardous waste storage or treatment tank and its associated ancillary equipment and containment system."

The tank design and operating standards for LQGs are specified at 40 CFR Part 265 Subpart J. The standards for LQGs are beyond the scope of this guidance. LQGs should consult the rules and contact the department for assistance if necessary before installation and use of a tank.

There are no specific design or operating standards for any type of units specified at 40CFR 261.5 for CESQGs. CESQGs need only maintain and operate their evaporator in a manner that prevents release of VHCs to the environment to be in compliance.

SQGs are only subject to portions of the tank standards applicable to LQGs at 40 CFR 265 Subpart J. SQGs must comply with the following requirements:

1. Do not place hazardous waste in a tank if it may cause rupture, leaks, corrosion, or otherwise cause the tank to fail.
2. Keep tank covered or provide at least two feet of freeboard (space at the top of the tank) in uncovered tanks.
3. Inspect any monitoring or gauging systems on each operating day and inspect the tanks themselves for leaks or corrosion every week.
4. Use the National Fire Protection Association's (NFPA) buffer zone requirements for tanks containing ignitable or reactive waste. These requirements specify distances considered as safe buffer zones for various liquids based on the characteristics of

all combustible and flammable liquids. Your local fire department can provide assistance with this requirement.

5. Do not store waste in the tank for more than 180 days before evaporating.

There are several companies that are selling evaporators that meet tank design requirements. The dry cleaner industry has shown particular interest in the use of evaporators for the disposal of perchloroethylene contaminated wastewater. Because of this interest the department has developed some specific recommendations for the drycleaners and will address them here. The recommendations are as follows:

1. Only use devices that meet the definition of "tank" and are designed and operated according to the appropriate regulatory standards, which are dependent on whether the facility is a CESQG, SQG or LQG.

2. Prefilter the wastewater to remove solvent. The department is aware that it may not be feasible to completely remove all solvent. Post filtration levels of one (1) part per million and below is achievable. If filtration equipment capable of meeting these levels is being properly used the department will consider the performance standard to minimize releases under 40 CFR 265.31 to be met. Alternately a capture device may be used to prevent release of VHCs.

3. Maintain the filtering apparatus or capture devices according to manufacturing instructions.

4. Maintain the manufacturer's instructions and specifications on site to assist the operator in proper equipment use and to demonstrate to the department that the equipment and filtration media or capture device is being utilized per manufacturer's instructions.

5. Maintain records of equipment maintenance, filter changes, quantities of waste treated and other information as relevant to demonstrate proper equipment use.

Though the above recommendations are specific to drycleaners they may be useful to other industries contemplating the use of evaporators for wastewaters. It should be noted that the use of evaporators by drycleaners generally involves very small quantities of wastewater with very low concentrations of VHCs to begin with. Removal of the solvents by filtration is easily accomplished. The practicality of the use of evaporators for wastewaters generated by other industrial processes where greater quantities of waste is involved or which contain higher VHCs would have to be evaluated on a case by case basis.

Generators are reminded that the filter media must be evaluated to determine if it is a hazardous waste and managed accordingly. If wastewaters contain listed hazardous waste of any type the filter media will be a hazardous waste pursuant to the "derived from" rule at 40 CFR 261.3. Where listed waste is not involved the filter media must still be evaluated to determine if it is a characteristic hazardous waste. The generation and management of the filter media should be taken into account when evaluating the use of an evaporator.

In conclusion, under limited circumstances the use of evaporators by generators for dewatering hazardous waste may be conducted without a permit only if applicable management standards, as discussed above, are complied with. The overriding requirement is that hazardous waste constituents are not released to the environment. If you have questions regarding this guidance, or other questions regarding hazardous waste management please contact the Office of Land Quality, Compliance and Response Branch, Industrial Waste Section of IDEM at 317/308-3031or 1-800-451-6027.

DEPARTMENT OF STATE REVENUE
Departmental Notice #2
December 1, 2000
Prepayment Of Sales Tax On Gasoline

This document is not a "statement" required to be published in the Indiana Register under IC 4-22-7-7. However, under IC 6-2.5-7-14, the Department is required to publish the prepayment rate in the June and December issues of the Indiana Register. The purpose of this notice is to inform each refiner, terminal operator, and qualified distributor known to the Department to be required to collect prepayments of sales tax on gasoline of the "prepayment rate" effective for the next six-month period. A prepayment rate is calculated twice a year by the Department and is effective for the period of January 1 through June 30, or, July 1 through December 31, as appropriate.

The prepayment rate is defined by IC 6-2.5-7-1 as the product of:

(1) the statewide average retail price per gallon of gasoline (excluding the Indiana gasoline tax, the federal gasoline tax, and the Indiana gross retail tax); multiplied by

(2) the state gross retail tax rate [5%]; multiplied by

(3) ninety percent (90%); and then

(4) rounded to the nearest one-tenth of one cent ($0.001).

The prepayment rate of sales tax on gasoline for the six- (6) month period beginning January 1, 2001, is four and nine-tenths cents ($0.049) per gallon.

Using the most recent retail price of gasoline available (as required by IC 6-2.5-7-14(b)), the Department has determined the statewide average retail price per gallon of gasoline (all grades) to be one dollar eight and eight-tenths cents ($1.088). (The 'most recent retail price of gasoline available' was based on July, 2000, data contained in the Petroleum Marketing Monthly of October, 2000, published by the Federal Energy Information Administration, Department of Energy.)

The prepayment rates for periods beginning July 1, 1994, are set out below:

PERIOD	RATE PER GALLON
Jul 1, 1994 to Dec 31, 1994	2.9 cents
Jan 1, 1995 to Jun 30, 1995	3.7 cents
Jul 1, 1995 to Dec 31, 1995	3.3 cents
Jan 1, 1996 to Jun 30, 1996	3.3 cents
Jul 1, 1996 to Dec 31, 1996	3.4 cents
Jan 1, 1997 to Jun 30, 1997	4.0 cents
Jul 1, 1997 to Dec 31, 1997	3.9 cents
Jan 1, 1998 to Jun 30, 1998	4.0 cents
Jul 1, 1998 to Dec 31, 1998	2.9 cents
Jan 1, 1999 to Jun 30, 1999	3.0 cents
Jul 1, 1999 to Dec 31, 1999	2.4 cents
Jan 1, 2000 to Jun 30, 2000	3.6 cents
Jul 1, 2000 to Dec 31, 2000	4.6 cents
Jan 1, 2001 to Jun 30, 2001	4.9 cents

Department of State Revenue
Kenneth L. Miller
Commissioner

INDIANA DEPARTMENT OF REVENUE
Departmental Notice #3
November 1, 2000
Interest Rates For Calendar Year 2001

This document does not meet the definition of a **statement"** required to be published in the *Indiana Register* under IC 4-22-7-7. However, under IC 6-8.1-10-1(c), the Commissioner is required to establish, on or before November 1 of each year, the applicable interest rates for tax overpayments and underpayments that will take effect for the immediately succeeding calendar year. The purpose of this notice is to inform the public of the interest rates that will be effective for the calendar year beginning January 1, 2001.

The rate of the interest for an excess tax payment is the percentage rounded to the nearest whole number that equals the average investment yield on state money for the state's previous fiscal year, excluding pension fund investments, as published in the Auditor of State's comprehensive annual financial report. Based on this calculation, the rate of interest for an excess tax payment for calendar year 2001 will be six percent (6%).

The rate of interest for an underpayment of tax is the percentage rounded to the nearest whole number that equals two (2) percentage points above the average investment yield on state money for the state's previous fiscal year, excluding pension fund investments, as published in the Auditor of State's comprehensive annual financial report. Based on this calculation, the rate of interest for an underpayment of tax for calendar year 2001 will be eight percent (8%).

For taxpayer information, attached is a list of comparable percentages applicable in previous calendar years.

Department of State Revenue
Kenneth L. Miller
Commissioner
Attachment

YEAR	OVERPAYMENTS	DELINQUENT PAYMENTS
1989	10%	10%
1990	10%	10%
1991	10%	10%

1992	8%	8%
1993	7%	7%
1994	7%	7%
1995	4%	6%
1996	5%	7%
1997	5%	7%
1998	5%	7%
1999	5%	7%
2000	5%	7%
2001	6%	8%

DEPARTMENT OF STATE REVENUE

03950335.LOF

LETTER OF FINDINGS NUMBER: 95-0335
Withholding Tax / Responsible Officer Liability
For Years 1985, 1986, and 1987

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning the specific issue.

ISSUES

I. Responsible Officer Liability – Duty to Remit Withholding Taxes: Burden of Proof for Establishing Validity of Withholding Tax Assessment

Authority: IC 6-3-4-8; IC 6-3-4-8(f); IC 6-8.1-5-1

The taxpayer protests the assessment of withholding taxes. Taxpayer maintains that the department has not produced records which establish that he owes these taxes. Further, the taxpayer argues that he is not responsible for preserving the relevant business records over an extended period of time.

II. Abatement of Interest Charges Accrued Since the Original Withholding Tax Assessment

Even assuming that the Department could meet is purported burden of proof and demonstrate that the taxpayer was originally responsible for remitting withholding taxes, taxpayer argues that because of the delay in responding to the taxpayer's protest, wholly attributable to the Department according to Taxpayer, the interest which has accrued on the original assessment should be entirely abated.

STATEMENT OF FACTS

The taxpayer was assessed for unpaid withholding taxes in a series of AR-80 Proposed Assessments issued during 1995. The assessments resulted from a time during which taxpayer operated a tool and engineering company. The taxpayer has declined to discuss the company, his role in that tool company, or the circumstances under which the WH-1 forms were received by the Department but were not accompanied by payment.

I. Responsible Officer Liability – Duty to Remit Withholding Taxes: Burden of Proof for Establishing Validity of Withholding Tax Assessment

DISCUSSION

IC 6-3-4-8 imposes upon employers the responsibility for withholding state income taxes and remitting those taxes to the state. Under IC 6-3-4-8(f), the taxes which have been withheld belong to the State of Indiana. The employer is charged with the duty of "hold[ing] the [taxes] in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided."

In the face of the series of assessments for unpaid withholding taxes, taxpayer maintains that he is certain that he paid the taxes at the time the taxes were originally due. Additionally, the taxpayer maintains that the Department has failed to prove either that the amount of the assessment is correct or that the taxpayer indeed did not pay them when originally due. However, the taxpayer has failed to provide any evidence the taxes were paid. Further, the taxpayer has failed to provide any explanation for his failure to provide that evidence at the time the purportedly erroneous assessments were levied.

Taxpayer misapprehends the burden of proof surrounding the notice of a proposed tax assessment. The amount of the original assessments was predicated on the information taxpayer provided on the withholding forms. In addition, IC 6-8.1-5-1 states that "[t]he notice of proposed assessment is prima facie evidence that the department's claim for 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."

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of Interest Charges Accrued Since the Original Withholding Tax Assessment

The taxpayer makes a general equitable argument favoring the abatement of all interest which has accrued since the time the taxes were originally due. Taxpayer argues that the lengthy delay in issuing the AR-80 proposed assessment forms and the delay in responding to the taxpayer's protest, filed in 1995, is entirely attributable to the Department.

The issue of whether the Department or the taxpayer is responsible for the delay in responding to the taxpayer's protest is irrelevant. The Department is without the statutory or equitable authority to abate the interest which has accrued on the unpaid taxes. Absent authority to abate that interest, the Department must decline the opportunity to do so.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02960515.LOF

LETTER OF FINDINGS NUMBER: 96-0515 RST
Gross Income Tax
For the Periods: 1989 through 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax – High Rate v. Low Rate

Authority: IC 6-2.1-2-1; IC 6-2.5-3-2; IC 6-2.1-2-3; Information Bulletin No. 2

The taxpayer protests that its receipts from software upgrade contracts were taxed at the high rate for gross income tax.

II. Tax Administration – Imposition of Negligence Penalty

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

Taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is a producer of computer software for sale to the public with software support as a large part of the taxpayer's sales. The taxpayer's revenue at issue consists of revenue from the sale of software maintenance contracts and revenue from consulting and education services. The taxpayer treated these sales as sales of tangible personal property as related to gross income tax rates.

A sales and use tax audit was performed concurrently with the gross income audit. The taxpayer was collecting sales tax on most of its software maintenance contract invoices and the auditor assessed sales tax on the remainder. The auditor also assessed the higher gross income tax rate for service contracts on the software maintenance contracts and the consulting and education service contracts. While the taxpayer concedes that the higher gross income tax rate for services would apply to the consulting and education service contracts, the taxpayer protests that in spite of the Department's recognition that the software maintenance contracts were tangible personal property in the sales and use audit, the receipts of the contracts were taxed as a service at the high rate.

I. Gross Income Tax – High Rate v. Low Rate

DISCUSSION

At issue is whether the taxpayer is acting as a retail merchant or a service provider in the context of its software maintenance contracts. The taxpayer states that it is acting as a retail merchant, therefore their receipts are subject to the "low" rate of Indiana Gross Income taxation.

IC 6-2.1-2-3 sets the rates of tax for gross income:

> The receipt of gross income from transactions described in Section 4 of this chapter is subject to a tax rate of three-tenths of one percent (0.3%).
>
> The receipt of gross income from transactions described in Section 5 of this chapter is subject to a tax rate of one and two-tenths percent (1.2%).

The transactions contained in Section 4 of IC 6-2.1-2 include selling at retail and are taxed at the "low" rate of three-tenths of one percent (.3%). Transactions found in Section 5 include services and are taxed at the "high" rate of one and two-tenths percent (1.2%).

IC 6-2.1-2-1(b)(1) defines selling at retail as a " transaction in which a retail merchant in the ordinary course of his regularly conducted business transfers the ownership of tangible personal property to another, conditionally or otherwise, for a consideration...."

At a minimum, maintenance contract customers receive one major update per year. The taxpayer treats these sales as tangible personal property per Information Bulletin No. 2, which states:

A computer software company sells a taxable software package to a customer for $2,000. The customer also purchases a maintenance agreement from the company. The customer did not have to buy the maintenance agreement. The agreement entitles the customer to up to twenty hours of programmer help to deal with any problems the customer might have in using the software package. The maintenance agreement is an optional maintenance agreement and is not subject to sales tax.

Same facts as in Example 4, but the maintenance agreement also entitles the customer to four program updates per year. The program updates are available to all of the company's customers who purchased the software package. The maintenance is subject to sales tax because it is a certainty that tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement.

Sales tax was collected in the sales of the software support contract. The taxpayer is acting as a retail merchant in its sales of the software support contracts. As indicated in the bulletin, it is possible for some of the maintenance contracts to be treated as service contracts, but to the extent that taxpayer's sales, as verified in the sales and use tax audit, are having the sales tax assessed they are subject to the "low" rate of income tax provided in IC 6-2.1-2-3(a).

FINDING

The taxpayer's protest is sustained. The sales with sales tax reported and the sales tax assessed are subject to the "low" rate of gross income tax.

II. Tax Administration – Imposition of Negligence Penalty

DISCUSSION

Indiana Code 6-8.1-10-2.1(d) states, in part, that if, "the deficiency determined by the Department was due to reasonable cause and not willful neglect, the Department shall waive the penalty.

Regulation 45 IAC 15-11-2(b) also states, in part:

(b) 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.

The auditor noted that the taxpayer filed late for three of the audit years; additionally the taxpayer did not protest the auditor's findings related to gross income tax on consulting and educational services. Both timely filings and the application of the correct gross income rates for the aforementioned services constitute a failure to use reasonable care, caution, or diligence by the taxpayer. Consequently, the negligence penalty will apply to this assessment.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

1597010.RTA

LETTER OF FINDINGS NUMBER: 15-97010 RTA
Motor Carrier Fuel Surcharge Tax
For the Period 1990-96

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the *Indiana Register* and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the *Indiana Register*. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

The Department would restate the single issue that the taxpayer raised as presenting the following issues:

I. Motor Carrier Fuel Surcharge Tax – "Commercial Motor Vehicle" Status – "Farm-Plated Vehicle" Exemption

Authority: 7 U.S.C. §§ 6932, 6962 (1994, corrected Supp. I 1995); 16 U.S.C. § 3801(a)(1) (1988 and 1994); 16 U.S.C. § 3821(b) (Supp. II 1990 and 1994); 16 U.S.C. § 3821(c) (Supp. III 1997); 16 U.S.C. § 3822(c) (1988); 16 U.S.C. § 3822(f)(1) (Supp. II 1990); 26 U.S.C. (I.R.C.) §§ 611(a) and 613(a) and (b)(6); 29 U.S.C. §§ 203(f) and 213(a)(6); 30 U.S.C. § 3; 33 U.S.C. § 1344 (1988 and 1994); IC §§ 6-2.5-5-5.1, 6-6-4.1-1(b), 6-6-4.1-4.5, 15-4-9-1, 15-7-1-2(a), 22-12-1-2, 22-12-1-4(c), 26-1-9-109(3) (1988 and 1993); IC § 6-3-1-17 (1988); IC § 22-3-2-9(a) (1988, 1993 and Supp. 1997); IC § 9-1-4-41(i) (Supp. 1990); IC § 6-6-4.1-2(b)(4) (Supps. 1990-91 and 1993); IC §§ 9-13-2-30, 9-29-5-13 (Supp. 1991 and 1993); IC § 6-3-1-11(b) (1993); *Amoco Prod. Co. v. Southern Ute Indian Tribe*, 119 S.Ct. 1719 (U.S. 1999); *Farmers Reservoir & Irrigation Co. v. McComb*, 69 S.Ct. 1274 (U.S. 1949); *Michigan Peat Div. v. U.S. Envtl. Protection Agency*, 175 F.3d 422 (6th Cir. 1999); *McMurray v. Commissioner*, 985 F.2d 36 (1st Cir. 1993); *United States v. Huebner*, 752 F.2d 1235 (7th Cir. 1985); *A. Duda & Sons, Inc. v. United States*, 560 F.2d 669 (5th Cir. 1977); *Wirtz* *v. Ti Ti Peat Humus Co.*, 373 F.2d 209 (4th Cir. 1967); *United States v. Dierckman*, 41 F.Supp.2d 870 (S.D. Ind. 1998), *aff'd* 201 F.3d 915 (7th Cir. 2000); *Walling v. Georgia Peat Moss Co.*, 7 Lab. Cas. (CCH) & 61,622 (M.D. Ga. 1943); *H.J. Heinz Co. v. Chavez,* 140 N.E.2d 500 (Ind. 1957); *Cypress Creek Coal Co. v. Boonville Mining Co.*, 142 N.E. 645 (Ind. 1924); *Evans v. Hardy*, 76 Ind. 527 (1881); *Owens v. Lewis*, 46 Ind. 488 (1874); *Lindley v. Kelly*, 42 Ind. 294 (1873); *Day v. Ryan*, 560 N.E.2d 77 (Ind. Ct. App. 1990); *Fleckles v. Hille*; 149 N.E. 915 (Ind. App. 1925); *Hanna v. Warren*, 133 N.E. 9 (Ind. App. 1921); *Hardin v. Vestal*, 162 S.W.2d 923 (Ark. 1942); *Craddock v. Riddlesbarger*, 2 Dana (32 Ky.) 205 (1834); *Dillenbeck v. State*, 83 N.Y.S.2d 308 (N.Y. Ct. Cl. 1948); *Davis v. Industrial Comm'n,* 206 P. 267 (Utah 1922); *Rhod-A-Zalea & 35th, Inc. v. Snohomish County*, 959 P.2d 1024 (Wash. 1998); *Clarke v. Alstores Realty Corp.*, 527 P.2d 698 (Wash. Ct. App. 1974); 7 CFR Part 12 (1987-2000); 26 CFR (Treas. Reg.) §§ 1.611-1(d)(5) and 1.613-2(a)(1)(v) (1961-99); 29 CFR § 780.112 (1999); 36 CFR § 228.41(c) (1991-99); U.S. Dep't of Labor, Standard Industrial Classification Manual, Industry Group 1499 (1987); 45 IAC § 13-2-2(5) and art. 13, Rule 8.5 (1988, 1992 and 1996); 1953 Op. Att'y Gen. No. 100, at 467

Did certain "farm-plated" motor vehicles of the taxpayer become "commercial motor vehicles" once the taxpayer began using them to transport raw peat, existing naturally on land that the taxpayer was farming, and that the taxpayer was extracting, selling and hauling over public highways to deliver to the buyer's off-farm place of business? To answer this question, the Department *sua sponte* raises the following sub-issues:

A. Was the taxpayer's hauling of peat in the farm-plated trucks an agricultural pursuit usual and normal to his farming operation?

B. If the answer to Sub-Issue I.A is "no," was the taxpayer operating those trucks in the conduct of a commercial enterprise?

II. Motor Carrier Fuel Surcharge Tax – Imposition – "Carrier" Status

Authority: IC § 6-6-4.1-1(a) and (b) (1988 and 1993); IC § 9-1-4-41(i) (Supp. 1990); IC § 9-29-5-13(c) (Supp. 1991 and 1993); 45 IAC § 13-2-2(5)(C) (1988, 1992 and 1996)

In light of the answer to Issue I, did the taxpayer become a "carrier" as to the peat hauling operation?

III. Motor Carrier Fuel Surcharge Tax – Imposition

Authority: IC § 6-6-4.1-4.5(a) (1988 and 1993)

If the answers to Issues I and II are "yes," was the consumption of the fuel by the "farm-plated" motor vehicles used in the taxpayer's peat hauling operation subject to motor carrier fuel surtax?

IV. Motor Carrier Fuel Surtax – Imposition – Estoppel Against /Waiver of Assessment

Authority: 45 IAC § 15-3-2(e) (1988, 1992 and 1996)

If the consumption was surtaxable, is the Department now barred from assessing that surtax by virtue of certain written and oral statements of other state agencies or their employees?

V. Penalties

Authority: IC § 6-6-4.1-23 (Supps. 1990-91 and 1993); IC § 6-8.1-10-2 (Supp. 1990); IC § 6-8.1-10-2.1 (Supp. 1991 and 1993); 45 IAC § 15-11-2(b) (1988, 1992 and 1996)

Does reasonable cause exist to waive the penalties the Department assessed?

STATEMENT OF FACTS

During the investigation period the taxpayer operated (and still operates) a farm, and as part of that operation also owned trucks for which the Indiana Bureau of Motor Vehicles had issued license plates as farm trucks. The farm is near a river bordered by a marsh. As a result of that marsh, there is a substantial amount of peat under the topsoil of the farm, which during the investigation period consisted of land that the taxpayer both owned and leased. The taxpayer stated that the peat under the farm occurred naturally. The taxpayer did not create the bog out of which it came and did nothing to expand that marsh until after extracting peat from under a given parcel of his farm, as the Department will describe below.

The taxpayer extracted or severed raw peat from under the topsoil on his farm during the investigation period and sold it to a company that owned a processing plant. The plant was and is located in a nearby Indiana town. He delivered the peat by hauling it over public highways in several of his "farm-plated" trucks, consuming tax-exempt dyed special fuel in the process. The delivery route was entirely within Indiana. All of the trucks used had a declared gross weight of twenty-six thousand pounds (26,000 lb.) or more.

Fuel excise tax authorities of the United States Treasury Department's Internal Revenue Service (hereafter "the IRS") became aware of the taxpayer's peat hauling activities and conducted a joint investigation with this Department of his resulting fuel tax liabilities. As a result of the Department's investigation, it issued Notices of Proposed Assessments of special fuel tax on the exempt-dyed special fuel that his farm trucks had consumed. The taxpayer protested the negligence penalty that the Department assessed for those liabilities, which the Department denied. However, the taxpayer did not protest the tax itself, and those liabilities therefore are not in issue in the present protest.

The Department also issued the present motor carrier fuel surtax Notices of Proposed Assessments. The taxpayer also timely protested these assessments; the Department gave written notice of a protest hearing setting and held that hearing, at which the taxpayer submitted the evidence set out below.

The actual presence of peat under any given plot of the taxpayer's farmland was verified through soil tests. However, before beginning to remove peat, the taxpayer had to get prior approval from the federal agency having environmental jurisdiction over the land type in question. At least four times during the investigation period, the office of the U.S. Agriculture Department's former Soil Conservation Service (hereafter "the SCS") for the taxpayer's county used aerial photographs of various parcels of the taxpayer's farm to classify those parcels according to their wetland status. The classifications the SCS used included Wetlands (W), Farmed Wetlands (FW), Minimal Effect Wetlands (MW) and Prior Converted Wetlands (PC), among others. The taxpayer stated at the hearing that the SCS would allow him to sever peat only from under plots it had identified as being MW or PC. The taxpayer also said at the hearing that persons wanting to extract peat from under lands classified as W or FW must get a permit to do so from the U.S. Army's Corps of Engineers. However, he represented that he engaged in no peat removal activities requiring such a permit during the investigation period.

The taxpayer severed the peat by disking and scraping up the layer of topsoil over it. He then dried the peat before hauling it to the local processing plant. All sales contracts between the parties were oral; the processing plant's representative advised the taxpayer yearly how much peat the plant would need. There is no evidence in the record of any stockpiling of raw peat on the farm, suggesting that it was extracted for sale on an "as needed" basis. After completing the extraction of the peat from under any given parcel of the farm, the taxpayer would plant sorghum on that parcel, in coordination with the Indiana Department of Natural Resources, in order to convert that parcel to wetlands and attract associated wildlife.

According to the taxpayer, peat's primary use, and the use for which he sold his peat to the local processing plant, is in horticulture or home gardening; however, the taxpayer said at the hearing that he did not and does not grow horticultural crops. He also said at the hearing that processed peat can't be used profitably in the cultivation of most agricultural crops. There is also no evidence in the record that severing the peat was necessary in order for the taxpayer to prepare his farmland, or to maintain and preserve its fitness, for growing crops or pasturing livestock.

The taxpayer did not claim the Internal Revenue Code's peat depletion allowance for any of the years investigated. The hearings officer asked one of the accountants that attended the hearing why the peat depletion allowance had not been taken. The accountant advised the hearings officer that one reason for not doing so was to avoid lowering the federal tax value (what the Internal Revenue Code calls the "basis") of the farmland that the taxpayer owned.

The taxpayer also stated that in the early 1990s he orally asked two employees of state agencies other than this Department about whether the taxpayer was required to pay fuel tax on the dyed fuel he was consuming in his peat hauling operation. The state employees with whom the taxpayer talked were an employee of the Department of Transportation and a member of the State Police stationed at a nearby post. The taxpayer represented to the hearings officer that each of these state employees orally advised him that he was not liable for fuel tax. The Department notes that the taxpayer also made these allegations during the earlier protest of the negligence penalty assessed against the taxpayer for failing to pay special fuel tax. However, the taxpayer has never submitted any documentary evidence of these opinions There is also no evidence that the taxpayer ever asked this Department to issue a letter ruling on whether the dyed fuel consumed was taxable.

I. Imposition of Motor Carrier Fuel Surcharge Tax – Commercial Motor Vehicle Status – "Farm-Plated Vehicle" Exemption

DISCUSSION

A. INTRODUCTION: HISTORICAL BACKGROUND AND ANALYTICAL FRAMEWORK

P.L.59-1985, sec. 17, 1985 Ind. Acts 553, 566 created the motor carrier fuel surtax by adding IC § 6-6-4.1-4.5 to the Motor Carrier Fuel Tax Law, P.L.59, sec. 1, 1982 Ind. Acts 523, 523-30, codified as amended at IC ch 6-6-4.1 (1988, 1993 and 1998). IC § 6-6-4.1-4.5(a), the imposition subsection, describes the money exaction as a "surcharge tax[,]" *id.*, and the Indiana Supreme Court accordingly named IC § 6-6-4.1-4.5 the Surcharge Tax Act in *Indiana Dep't of State Revenue v. Bulkmatic Transp. Co.,* 648 N.E.2d 1156, 1159 (Ind. 1995). The Department therefore will refer to the exaction at issue in this protest interchangeably as "the motor carrier fuel surcharge tax" or "the motor carrier fuel surtax," or more simply as "the surcharge tax" or "the surtax," since at this writing it is the only such listed tax.

As noted above, the Surcharge Tax Act was passed in 1985. The Department promulgated 45 IAC art. 13, Rule 8.5 (1988, 1992 and 1996), the implementing regulation, the following year. LSA Document # 85-107(f), sec. 14, 9 Ind. Reg. 2191, 2195 (1986). Neither IC § 6-6-4.1-4.5(a), Rule 8.5 nor certain terms to which they refer, defined in the Motor Carrier Fuel Tax Law and its implementing regulations and discussed below, have been amended since they respectively became effective. All of the foregoing provisions thus applied in their respective original forms throughout the years of 1990-96, which constitute the taxpayer's investigation period. Accordingly, unless otherwise noted, all further citations in this letter of findings to IC ch. 6-6-4.1 or to 45 IAC art. 13 refer to the editions of the Indiana Code and the Indiana Administrative Code that governed during that investigation period. Specifically, any further references to any provision of IC ch. 6-6-4.1 are to the 1988 and 1993 editions of the Indiana Code, while any further citations to any provision of 45 IAC art. 13 refer to the 1988, 1992 and 1996 editions of the Indiana Administrative Code, unless otherwise noted.

In discussing the foregoing authorities, and relevant federal statutes and regulations, at times it will be necessary for the Department to use dictionary definitions of certain words for which there is either no statutory, regulatory or judicial definition. Under such circumstances the meaning of a word in the Indiana Code is governed by IC § 1-1-4-1(1) (1988, 1993 and 1998). That subsection states in part that "[w]ords and phrases [used in the Indiana Code] shall be taken in their plain, or ordinary and usual, sense." "A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, *contemporary*, common meaning." *Perrin v. United States,* 100 S.Ct. 311, 314 (U.S. 1979)(emphasis added). The ordinary, contemporary, common meaning of a non-technical word is the meaning found in English language dictionaries in existence at the time of the statute's enactment. *See id.* The Department's analysis of Indiana Tax Court opinions indicates that that court is most likely to refer to WEBSTER'S THIRD NEW INT'L DICTIONARY (hereafter "WEBSTER'S THIRD") in defining a non-technical word or phrase in a statute or regulation. The Indiana statutes and regulations at issue in this protest were enacted or promulgated between 1969 and 1991. WEBSTER'S THIRD has been in existence since 1961, when the first edition of that dictionary was published. Accordingly, where necessary in the following discussion to give the contemporary definition of a non-technical word or phrase in the "farm plating" statutes and regulation, the Department, like the Tax Court, also will refer to WEBSTER'S THIRD, and in particular to the first edition of 1961, unless otherwise indicated. The Department will also refer to older dictionaries where needed to define agricultural, or agriculture-related, words in statutes that the General Assembly enacted before the "farm-plated" exemption, but of which it was presumed to have been aware in doing so.

B. TAXPAYER'S ARGUMENT

The taxpayer argues that raw peat is a "farm product" or "farm commodity" as 45 IAC § 13-2-2(5)(C) uses these terms. That letter quotes IC §§ 9-13-2-54 and 9-20-4-2(a) and (c) (1993) (P.L.2-1991, secs. 1 and 8, 1991 Ind. Acts 191, 201 and 353, respectively). These statutes purport to define "farm commodities" for purposes of the maximum weight restriction for hauling such products. The taxpayer infers that the definition of "farm commodities" is non-restrictive from the use of the word "includes" in IC § 9-20-4-2(c) (1993), and that raw peat is therefore a farm commodity. To bolster this argument, the taxpayer cites to IOWA ADMIN. CODE § 761-400.47(321), which defines peat as a "raw farm product" under that state's maximum road weight laws. *Id.*

Although the taxpayer has cited to a regulation of another state rather than to any Indiana legal authority, the Department agrees with the taxpayer that raw peat's legal status or lack of status as a farm product is relevant, as will be shown below. However, the taxpayer has cited the wrong authorities to support its argument, since maximum road weight restrictions on hauling farm commodities is not the issue. The issue is whether the peat-hauling motor vehicles were qualified to be "farm-plated," which in turn would make their fuel consumption exempt from surcharge tax. As the Department will show below, both IC § 6-6-4.1-2(b)(4) and 45 IAC § 13-2-2(b)(5)(A) require that the vehicle in question be "qualified to be registered and used as" a farm truck, farm trailer or farm semitrailer and tractor. *Id.* If they were not so entitled, then they were "commercial motor vehicles" and their consumption was subject to surtax.

C. "FARM-PLATED" VEHICLE STATUTORY AND REGULATORY BACKGROUND

1. Motor Carrier Fuel Tax Statutes and Regulations
Governing the "Farm-Plated" Vehicle Exemption

IC § 6-6-4.1-1(b) defines a "commercial motor vehicle" in relevant part as "a vehicle... not excluded from the application of this chapter under [IC § 6-6-4.1-2(b)]." The "farm-plated" vehicle exclusion is found in IC § 6-6-4.1-2(b)(4). The General Assembly added it to the Motor Carrier Fuel Tax Law the year after it enacted the latter statute. P.L.89-1983, sec. 1, 1983 Ind. Acts 723, 723. At the beginning, and for the first six quarters, of the taxpayer's investigation period, IC § 6-6-4.1-2(b)(4) read as follows:

(b) This chapter does not apply to:

.....

(4) trucks, trailers, or semitrailers and tractors that are qualified to be registered and used as farm trucks, farm trailers, or farm semitrailers and tractors and that are registered as such by the bureau of motor vehicles under IC 9-18 [Supp. 1991 and 1993] or under a similar law of another state[.]

P.L.89-1983, sec. 1, 1983 Ind. Acts 723, 723, as amended by P.L.77-1985, sec. 26, 1985 Ind. Acts 672, 684 and P.L.8-1988, sec. 3, 1988 Ind. Acts 458, 460. The same session law that contained the Surcharge Tax Act also redesignated former IC § 9-1-4-41(c) as former IC § 9-1-4-41(i). *Compare* P.L.59-1985, secs. 17 and 30, 1985 Ind. Acts 553, 566 and 582-83, respectively. The redesignation took effect on January 1, 1986. *Id.* sec. 43, 1985 Ind. Acts at 589. However, the General Assembly never enacted a conforming technical amendment to IC § 6-6-4.1-2(b)(4) to reflect this change. This legislative omission appears to the Department to have been inadvertent. It is permissible to interpret a statute that incorrectly cites to a section in another act as referring to a third section, if there is no difficulty in understanding the citing statute as referring to a provision other than the one cited. *Cummins v. Pence*, 91 N.E. 529, 532 (Ind. 1910). The Department will therefore administratively construe the citation to "IC 9-1-4-41(c)" in IC § 6-6-4.1-2(b)(4) (Supp. 1990) as referring to former IC § 9-1-4-41(i) for all reporting periods beginning on or after January 1, 1986 and ending on or before June 30, 1991. This interpretation will therefore apply to the present taxpayer's protest for calendar 1990 and the first two quarters of 1991.

In its 1991 session the General Assembly recodified IC title 9, the state's motor vehicle code, by enacting P.L.2-1991, 1991 Ind. Acts 191. P.L.2-1991 also amended IC § 6-6-4.1-2(b)(4) to conform to the recodification of IC title 9. *Id.* sec. 42, 1991 Ind. Acts at 688. Both the recodification and the amendment took effect July 1, 1991. *See* IC § 1-1-3-3(b) (1988 and 1993), which makes the effective date of an act passed at a regular legislative session the July 1 following enactment if the act does not specify a different date. After that amendment IC § 6-6-4.1-2(b)(4) read for the remainder of the present taxpayer's investigation period, and still reads, as follows:

(b) This chapter does not apply to:

.....

(4) trucks, trailers, or semitrailers and tractors that are qualified to be registered and used as farm trucks, farm trailers, or farm semitrailers and tractors and that are registered as such by the bureau of motor vehicles under IC 9-1-4-41(c) [(1988)] or under a similar law of another state[.]

Id. IC art. 9-18 sets out the general procedures for registering and obtaining license plates for motor vehicles. The fees charged under IC art. 9-18 are set forth in IC ch. 9-29-5. The reduced fees for the farm motor vehicles described in IC § 6-6-4.1-2(b)(4) and the criteria that a vehicle must meet to qualify for those fees, are set out in IC § 9-29-5-13, quoted below.

Lastly, 45 IAC § 13-2-2(5), the regulation implementing IC § 6-6-4.1-2(b)(4), read as follows throughout the taxpayer's investigation period:

Sec. 2. The following commercial motor vehicles are exempt from the application of IC 6-6-4.1:

.....

(5) after January 1, 1984, trucks, trailers, or semitrailers and tractors so long as the commercial motor vehicle:

(A) *is qualified to be registered and used as a farm truck, farm trailer, or farm semitrailer and tractor*;

(B) *is registered as such* by the Indiana bureau of motor vehicles; and

(C) *is not operated, either part time or incidentally, in the conduct of any commercial enterprise or in the transportation of farm products after such commodities have been delivered to the first point of delivery, where the commodities are weighed and title is transferred.*

Id (emphases added). The comparable federal fuel excise tax provisions are narrower than IC § 6-6-4.1-2(b)(4) as interpreted by 45 IAC § 13-2-2(5). Diesel fuel and gasoline must be used "on a farm for farming purposes" to be exempt from the federal taxes, or to have any such taxes collected credited against the farmer's income tax. Title 26 U.S.C. (I.R.C.) §§ 34(a)(1) and (a)(3), 4041(f), 6420(a), (c)(1) to (c)(3) and (g), 6427(c), (k)(1) and (k)(3) (1994). The oldest of these statutes to use the phrase "on a farm for farming purposes" is I.R.C. § 6420(a), which Congress enacted in Pub. L. 466, sec. 1, 70 Stat. 87, 87-88 (1956). Shortly after that enactment, the IRS interpreted I.R.C. § 6420(a) to mean that a farmer taxpayer is not entitled to relief concerning gasoline consumed on the public highways in transporting agricultural or horticultural products from the farm to market. Rev. Rul. 58-289, 1958-1 C.B. 494. The same rationale presumably bars relief under the other statutes as well.

Unlike the foregoing federal authorities, IC § 6-6-4.1-2(b)(4) as interpreted by 45 IAC § 13-2-2(5) does not restrict its exemption to motor fuel consumed on a farm. A farmer may therefore consume motor fuel on Indiana public highways exempt from motor carrier fuel and surcharge taxes if the consumption is done by a motor vehicle pursuant to 45 IAC § 13-2-2(5). That regulation requires in part that the motor vehicle be both "farm plated" and entitled to such plating. It is the latter requirement that identifies the circumstances under which such exempt consumption may take place, as the following discussion will show.

<u>2. Substantive Motor Vehicle "Farm Plating" Statutes</u>

IC § 9-1-4-41(i) (Supp. 1990) (formerly IC § 9-1-4-41(c) (Supp. 1984) and IC § 9-29-5-13(b) and (c) (Supp. 1991 and 1993), which are in substance the same, set out the applicable qualifications for farm plating. Like the first version of IC § 6-6-4.1-2(b)(4) set out above, IC § 9-1-4-41(i) controlled the first six quarters of the investigation period. It read in relevant part as follows:

Any owner of a motor vehicle, trailer or semi-trailer and tractor operated primarily as a farm truck, farm trailer, or farm semi-trailer and tractor having a declared gross weight of eleven thousand (11,000) pounds or more, *used by the owner or guest occupant in connection with agricultural pursuits usual and normal to the user's farming operation*, shall pay a license fee equal to fifty percent (50%) of the amount listed in this subsection for a truck, trailer or semitrailer and tractor of the same declared gross weight. Such "farm truck", "farm trailer", or "farm semitrailer and tractor" shall be identified as such in accordance with a regulation established by the bureau and *shall not be operated either part time or incidentally in the conduct of any commercial enterprise, or for the transportation of farm products after such commodities have entered the channels of commerce. For the purposes of this section, a commercial enterprise does not include the transportation of a farm commodity from the place of production to the first point of delivery where the commodity is weighed and title to the commodity is transferred.* A farm truck may be used for personal purposes if the vehicle otherwise qualifies for that class of registration.

Id (emphases added). The legislature enacted the original version of the above language in 1969 and two years later classified it to the then-new Indiana Code, originally as part of IC § 9-1-4-41(c) (1971). Ch. 321, sec. 1, 1969 Ind. Acts 1337, 1342 and P.L.No. 114, sec. 1, 1971 Ind. Acts 522, 527, respectively. The General Assembly revised the statute to substantially the above form by amendments in 1977, 1979 and 1980. P.L.119, sec. 1, 1977 Ind. Acts 598, 604; P.L.105, sec. 1, 1979 Ind. Acts 448, 454; and P.L.10, sec. 15, 1980 Ind. Acts 355, 374-75, respectively. In 1983, the same year that the General Assembly enacted IC § 6-6-4.1-2(b)(4), it also amended former IC § 9-1-4-41(c) (1982) to allow the described vehicles to be used "primarily," instead of "exclusively," as farm vehicles, and to add the last sentence authorizing personal use of farm vehicles. P.L.118-1983, sec. 4, 1983 Ind. Acts 901, 912-13. (As previously discussed above, former IC § 9-1-4-41(c) was redesignated as former IC § 9-1-4-41(i), and the Surcharge Tax Act was enacted, in 1985).

P.L.2-1991, sec. 109, 1991 Ind. Acts at 736, repealed former IC arts. 9-1 to -12 (1988), including former IC § 9-1-4-41(i), as part of the recodification of IC tit. 9 described above. The legislature replaced the part of former IC § 9-1-4-41(i) set out above with current IC § 9-29-5-13 (Supp. 1991 and 1993), which reads as follows:

> Sec. 13. (a) This section does not apply to a vehicle or person exempt from registration under IC 9-18[-1-1(1) to (3), which respectively exempt farm wagons, farm tractors and farm machinery].
>
> (b) The license fee for a motor vehicle, trailer, or semitrailer and tractor operated primarily as a farm truck, farm trailer, or farm semitrailer and tractor:
>
> (1) having a declared gross weight of at least eleven thousand (11,000) pounds; and
>
> (2) *used by the owner or guest occupant in connection with agricultural pursuits usual and normal to the user's farming operation;*
>
> is fifty percent (50%) of the amount listed in this chapter for a truck, trailer or semitrailer and tractor of the same declared gross weight.
>
> (c) A farm truck, farm trailer, or farm semitrailer and tractor described in subsection (b) *may not be operated either part time or incidentally in the conduct of a commercial enterprise or for the transportation of farm products after the commodities have entered the channels of commerce.*
>
> (d) A farm truck described in subsection (b) may be used for personal purposes if the vehicle otherwise qualifies for that class of registration. *As added by P.L.2-1991, SEC. 17*[, 1991 Ind. Acts 191, 597-98].

(Emphases added.) As can be seen, IC § 9-29-5-13(b) through (d) and the part of former IC § 9-1-4-41(i) quoted above are the same except for formatting and the relocation of the next to last sentence of that quotation, which defined "commercial enterprise," to IC § 9-13-2-30 (Supp. 1991 and 1993) with immaterial stylistic changes. *See* P.L.2-1991, sec. 1, 1991 Ind. Acts at 197, which created current IC § 9-13-2-30. Subsection 111(a) of P.L.2-1991, 1991 Ind. Acts at 737, says that

> [t]his act is intended to be a codification and restatement of applicable or corresponding provisions repealed by SECTION 109 of this act. If this act repeals and replaces a provision in the same form or in a restated form, *the substantive operation and effect of that provision continue uninterrupted.*

(Emphasis added.) Case law specifies the same result where a statute is simultaneously repealed and re-enacted. Under such circumstances the legislature intends that "*the law continue[] uninterrupted.*" *Van Allen v. State,* 467 N.E.2d 1210, 1214 (Ind. Ct. App. 1984) (emphasis in original; hereafter "Van Allen"). Both the repeal of former IC § 9-1-4-41(i) and its replacement with IC § 9-29-5-13 were effective July 1, 1991 by operation of IC § 1-1-3-3(b). The Department therefore must interpret current IC § 9-29-5-13(b) through (d) the same as the above quotation from former IC § 9-1-4-41(i) as a matter of law.

<u>D. "FARM PLATING" ISSUES AFFECTING</u>
<u>TAXPAYER'S TRUCKS' STATUS</u>

During the taxpayer's investigation period only one set of criteria thus existed under the above statutes and regulation to exclude the fuel consumed by a "farm-plated" motor vehicle from surtax. Specifically, those criteria are that the alleged farm truck, farm trailer or farm semitractor and trailer:

1. Be qualified for "farm plating" by:
   a. Having a declared gross weight of eleven thousand (11,000) pounds or more; and
   b. Being used "in connection with [an] agricultural pursuit[ ] usual and normal to [the farmer's] farming operation";
2. Be "farm-plated" in fact; and
3. Not be "operated either part-time or incidentally in the conduct of a commercial enterprise[.]"

There is no question that the taxpayer's trucks meet the minimum weight criterion for "farm plating"; all of the trucks used in the peat hauling operation weighed more than eleven thousand pounds (11,000 lb.). Nor is there any dispute that the motor vehicles were actually "farm plated." The questions left therefore are:

1. Was the taxpayer's use of the farm-plated trucks in the peat-hauling operation "in connection with [an] *agricultural pursuit usual and normal to [his] farming operation*"?
2. If the answer to Question 1 is "no," was the taxpayer operating those trucks "in the conduct of a *commercial enterprise*"?

(Emphases added.) In arriving at an answer to each question, certain rules of statutory interpretation will apply. The legislature in enacting a statute is presumed to be aware of court decisions (including federal court decisions) on the subject in question. *E.g., Stith Petroleum Co. v. Department of Audit and Control*, 5 N.E.2d 517, 519 (Ind. 1937). It is also presumed to be aware of existing statutes on the same subject. *E.g., Johnson County Farm Bureau Coop. Ass'n, Inc. v. Indiana Dep't of State Revenue,* 568 N.E.2d 578, 583 (Ind. Tax 1991), *aff'd and adopted* 585 N.E.2d 1336 (Ind. 1992). This presumed awareness of related statutes includes an awareness of judicial interpretations of those laws. *E.g., Grave v. Kittle*, 101 N.E.2d 830, 834 (Ind. App. 1951) (*en banc*). Lastly,

> [b]ecause of the rule that legislative enactments in derogation of common law must be strictly construed and narrowly applied, [citations omitted], [the Indiana Supreme Court] presume[s] that the legislature is aware of the common law and does not intend to make any change therein beyond what it declares either in express terms or by unmistakable implication. [Citations omitted.]

State Farm Fire & Cas. Co. v. Structo Div., King Seeley Thermos Co., 540 N.E.2d 597, 598 (Ind. 1989) (hereafter "*Structo*"). The General Assembly therefore was presumably aware of all the federal and Indiana acts on or affecting agriculture (including crops), and of all of the judicial opinions interpreting those statutes, that were in existence when it enacted the various statutes pertaining to "farm plating." The legislature was also aware of Indiana common law judicial decisions concerning or affecting agriculture and crops, which remain good law if a statute has not changed them. The Department's following analysis will be based on these premises. In addition, where not inconsistent with controlling federal or Indiana law, the Department will refer to judicial decisions from other states that the Department has found to be persuasive and helpful to its analysis.

E. "AGRICULTURAL PURSUITS"

1. Introduction

Neither IC titles 6 nor 9 define the words "agricultural" or "pursuits," or the phrase "agricultural pursuits," nor has the Department found any other statute that defines "agricultural pursuit" or "agricultural pursuits" comprehensively. The Department has found only one other place in the Indiana Code in which the phrase "agricultural pursuits" appears. That statute is IC § 20-12-37-4 (1988, 1993 and 1998), which makes Ainvolve[ment] in agricultural pursuits[,] *id.*, a qualification for two of the members of the board of trustees of Purdue University. However, the Department did not find a definition of "agricultural pursuits" in IC ch. 20-12-37. The only federal statute that the Department has found that uses the phrase "agricultural pursuit" is 7 U.S.C. § 433(c) (1988 and 1994), which codifies ch. 242, sec. 1, 60 Stat. 127 (1946). It states that for purposes of all federal statutory and regulatory authorities concerning the raising of fur-bearing animals in captivity, "the breeding, raising, producing, or marketing of such animals or their products by the producer shall be deemed an agricultural pursuit." *Id.* This statute (like IC §§ 9-13-2-54 and 9-20-4-2(a) and (c), which the taxpayer has cited to support its interpretation of the terms "farm product" or "farm commodity") simply insures that the activities described will be treated as being agricultural under other statutes. It does not purport to give a comprehensive definition of "agricultural pursuit." For this reason, the federal statute gives the Department guidance only as to the activities that the statute explicitly describes in determining what "agricultural pursuits" means or includes as used in former IC § 9-1-4-41(i) and current IC § 9-29-5-13(b).

The Department did not find any court opinions in the course of its research that construe the phrases "agricultural pursuit" or "agricultural pursuits" as used in any of the foregoing statutes. (However, as discussed below, there are opinions that define or describe "agriculture." There are also opinions that, in speaking generally about agriculture, refer to "agricultural pursuits.") It is therefore necessary for the Department to resort to the rules of statutory interpretation. "[A] statute is examined and interpreted as a whole and the language itself is scrutinized, including the grammatical structure of the clause or sentence at issue." *Clifft v. Indiana Dep't of State Revenue,* 660 N.E.2d 310, 316 (Ind. 1995). The words "agricultural pursuits" are a noun phrase, *i.e.* a group of closely related words used as a noun. M. SHERTZER, THE ELEMENTS OF GRAMMAR 6 (1986). The noun phrase itself consists of the adjective "agricultural" and the noun "pursuits," which it modifies. Since "pursuits" is the root word of this phrase, the Department will determine its meaning as used in context first. To do so, as previously noted, the Department will refer to WEBSTER'S THIRD.

2. Definitions of "Pursuit": The Agricultural Vocation Versus Agricultural Work/Labor

The most nearly applicable definition of "pursuit" in WEBSTER'S THIRD's describes it as "an activity that one pursues or engages in seriously and continually or frequently as a *vocation or profession* or as an avocation...: a way of life: OCCUPATION...." *Id.* at 1848, definition 2 a (emphasis added). Title 7 U.S.C. §433(c) and IC § 20-12-37-4, both previously mentioned above, appear to use the word in this sense, as do the Indiana judicial opinions that have mentioned "agricultural pursuits." For example, *State ex rel. Simpson v. Meeker*, 105 N.E. 906 (Ind. 1914), was a mandamus action to compel a county council to appropriate funds to pay part of the salary of a county agricultural agent. The Indiana Supreme Court reversed the trial court, which had ruled for the council. In doing so, the court observed that "[o]f necessity, the training of one about to engage in *agricultural pursuits* will differ materially from that of the artisan, and different methods of instruction and different sources of information must be supplied in the two instances." *Id.* at 908 (emphasis added). *Downing v. Indiana State Board of Agriculture*, 28 N.E. 123 (Ind. 1891), described the State Board of Agriculture created in 1851 (a predecessor in interest of the current State Fair Board) as "seek[ing] to bring together people engaged in *agricultural pursuits*," *id.* at 126 (emphasis added), and referred twice thereafter on the same page to "those engaged in *agricultural pursuits*[.]" *Id* (emphasis added). More recently, *Day v. Ryan*, 560 N.E.2d 77 (Ind. Ct. App. 1990) (hereafter "*Ryan*"), a zoning ordinance violation opinion, said "[t]hat the [defendants'] raising of the crops and the livestock were *agricultural pursuits* is beyond question." *Id.* at 81 (emphasis added). *Shatto v. McNulty*, 509 N.E.2d 897 (Ind. Ct. App. 1987), a nuisance abatement opinion, says that "[p]eople may not move to an established agricultural area and then maintain an action for nuisance against farmers because their senses are offended by the ordinary smells and activities which accompany *agricultural pursuits*." *Id.* at 900 (emphasis added). The Department will therefore hereafter refer to the phrase "agricultural pursuits" in the sense that these authorities use it as being "the agricultural vocation."

Grammatical problems arise, however, if "agricultural pursuits" means "the agricultural vocation." Since the statute uses the plural "pursuits," inserting this definition would cause the phrase to read "agricultural [vocations, professions, or occupations] usual and normal to [the motor vehicle user's] farming operation". As the discussion in the following subsection of this letter will explain in detail, "the term 'agriculture' is defined as *the* art or science of cultivating the soil, including the planting of seed, the harvesting of crops, and the raising, feeding and management of live stock or poultry." *Fleckles v. Hille*; 149 N.E. 915, 915 (Ind. App. 1925) (emphasis added). The use of the definite article "the" indicates that "agriculture" is a single (not plural) art or science; by extension, it is a single vocation, profession or occupation. Although it is possible to specialize in a particular type of agriculture, as the discussion below will show, it would be impossible for a motor vehicle user to engage in the general occupation of agriculture more than once at the same time, especially with respect to a single "farming operation."

However, "pursuit" is also a synonym of "work." WEBSTER'S THIRD at 1848 (defining "pursuit"). The same dictionary defines the noun "work" in relevant part as "*a specific task, duty, function, or assignment* often being a part or phase of some larger activity[.]" *Id.* at 2634, definition 1 e (emphasis added). If "pursuits" is read as meaning "work," the phrase in which "pursuits" appears would read "agricultural [work, tasks, duties, functions or assignments] usual and normal to [the motor vehicle user's] farming operation". This reading is much more natural than that which results from defining "pursuits" in its vocational sense, and is therefore probably what the General Assembly meant. The Department therefore administratively interprets the word "pursuits" in former IC § 9-1-4-41(i) and current IC § 9-29-5-13(b)(2) as meaning "work," and the phrase "agricultural pursuits" as meaning "agricultural work" or "agricultural labor." The Department will hereafter use one of these latter phrases when it refers to "agricultural pursuits" in this sense.

3. Judicial and Statutory Definitions of "Agriculture," "Agricultural" and Related Terms

a. Basic Judicial Definition of "Agriculture" Under Indiana Law

The most authoritative Indiana case to define "agriculture" is *Fleckles v. Hille*; 149 N.E. 915 (Ind. App. 1925) (hereafter "*Fleckles*"). That opinion interpreted the "farm or agricultural employee" exemption from entitlement to benefits found in the former Workmen's Compensation Act, ch. 106, sec. 9, 1915 Ind. Acts 392, 394, as amended by ch. 157, sec. 1, 1919 Ind. Acts 158, 159. The legislature re-enacted this statute as part of the current Workers' Compensation Act without change. Ch. 172, sec. 9, 1929 Ind. Acts 536, 539, codified as amended at IC § 22-3-2-9(a) (1988 and 1993 and Supp. 1997). By doing so the then Indiana Supreme Court deemed the General Assembly to have acquiesced in and adopted the then Indiana Appellate Court's interpretation of that statute in *Fleckles* and other opinions of the latter court. *Heffner v. White*, 47 N.E.2d 964, 966 (Ind. 1943). Moreover, a unanimous Indiana Supreme Court itself later quoted and thereby adopted *Fleckles'* definition of "agriculture" in *H.J. Heinz Co. v. Chavez,* 140 N.E.2d 500, 502 n.1 (Ind. 1957) (hereafter "*Chavez*"). Since both this state's legislature and highest court have adopted *Fleckles'* general definition of "agriculture," this definition is therefore the starting point for determining what "agriculture" is, includes and excludes, both in fact and in law, in Indiana.

In *Fleckles*, the then Industrial Board had made a worker's compensation award in favor of an employee of an egg- and poultry-producing business located on a farm, and the employer appealed that award to the Appellate Court. Deciding whether the Industrial Board had erred required the court to interpret the "farm or agricultural employee" exemption of the Workmen's Compensation Act cited above. In reversing the award, the court said that

> It is contended by appellee, and apparently the Industrial Board adopted that view, that in the operation of the farm appellants were in the business of raising poultry, to which business farming by them was but incidental; and that appellee was, therefore, not a farm or agricultural employee. This contention cannot prevail. *The terms "farm employee" and "agricultural employee" as used in this state have substantially the same meaning. If there is any difference, the latter expression, which necessarily includes the former, has a broader meaning.* See *Davis v. Industrial Comm.* (1922), 59 Utah, 607, 206 P. 267 [hereafter "*Davis*"].
>
> *The term "agriculture" is defined as the art or science of cultivating the soil, including the planting of seed, the harvesting of crops, and the raising, feeding and management of live stock or poultry.* See Webster's Dictionary; [other citations omitted].

149 N.E. at 915-16 (emphases added). Based on this analysis and definition, the court held that the employee was exempted from the act as a "farm or agricultural employee" because poultry production was agriculture. *Id.* at 916.

Fleckles implies that "agriculture" might be a broader word than "farming." *See* 149 N.E. at 915, as set out above. *Ryan*, quoted in the preceding subsection, asserts this proposition more emphatically, 560 N.E.2d at 81, citing *Fleckles*. In other words, all farming is agriculture, but not all agriculture is farming; farming and agriculture are substantially, but not totally, equivalent. Neither *Fleckles* nor *Ryan* explains the distinction between agriculture and farming. However, *Davis* cited in *Fleckles*, casts some light on the distinction by discussing agriculture at length and mentioning some of the activities besides farming that agriculture includes. In the course of that discussion the *Davis* court drew "the distinction between arable agriculture, which includes the cultivation of the ground and the growth of crops, and pastoral agriculture, which comprises merely the feeding and management of the flocks and herds of the farm[.]" 206 P. at 268 (internal quotation marks omitted). The court also noted during that discussion that agriculture can include "gardening or horticulture[,]" *id.*, an activity of tangential relevance to deciding the present protest.

However, *Fleckles* makes it clear that "[t]he terms 'farm employee' and 'agricultural employee' *as used in this state* have substantially the same meaning." 149 N.E. at 915 (emphasis added). The Department infers from this emphasized language that the Appellate Court impliedly took judicial notice that the overwhelming majority of agricultural activity in Indiana is farming, *i.e.* arable agriculture as described in *Davis*. (Matters of common knowledge are the kinds of facts that are judicially notable without the presentation of proof. *E.g., School City of Gary v. State ex rel. Gary Artists' League, Inc.*, 256 N.E.2d 909, 912 (Ind. 1970)). The inference that the Appellate Court judicially noted that agriculture in Indiana is substantially equivalent to farming is justified for two reasons. First, the Indiana Supreme Court had held, well before the Appellate Court decided *Fleckles*, that "[t]he courts take judicial notice of seasons, and of the general course of agriculture." *Abel v. Alexander*, 45 Ind. 523, 528 (1874). *Ross v. Boswell*, 60 Ind. 235, 240 (1877) and *Abshire v. Mather*, 27 Ind. 381, 382 (1866), are to the same effect. The Department interprets these pre-*Fleckles* holdings as allowing Indiana judges to judicially note the generally known conditions in Indiana as they affect agriculture, including the climate, soil, land usage and products resulting from agricultural activity. Second, in *Fleckles* itself, after substantially equating "farm employee" and "agricultural employee" the court went on to note that "[i]n this state it is *a matter of common knowledge* that poultry production by Indiana farmers is well nigh universal[.]" 149 N.E. at 916 (emphasis added).

Considered in this overall context, it thus becomes apparent that the Appellate Court in *Fleckles* based its interpretation of the phrase "farm or agricultural employee" on its judicially noting that agriculture in Indiana is in fact substantially equivalent to farming. This is not to say that *Fleckles* defines the words "farm" or "farming," as distinguished from agriculture; it does not. However, those meanings become clear from the dictionary definitions of "farm" and "farming," both standing alone and as contrasted with the distinction between arable and pastoral agriculture that *Davis* draws and the definition of "agriculture" in *Fleckles*. The relevant definition of the noun "farm" in one contemporary dictionary described it as "[a] tract of land devoted to general or special *cultivation* under a single control, whether that of its owner or of a tenant: as, a small *farm*; a wheat-, fruit-, dairy-, or market-*farm*." CENTURY DICTIONARY AND CYCLOPEDIA 2143 (1911) (definition 5; first emphasis supplied; later emphases in original; hereafter "CENTURY DICTIONARY"). The substance of this definition is included in the relevant definitions of the same word in one version of Webster's Dictionary in existence less than a decade after *Fleckles* was decided, which read as follows:

> **6.** Orig[inally], a piece of land held under lease for *cultivation*; hence, any tract of land (whether consisting of one or more parcels) devoted to agricultural purposes, generally under the management of a tenant or the owner; any parcel or group of parcels of land *cultivated* as a unit.
>
> **7.** Hence, *a plot or tract of land* devoted to the raising of domestic or other animals; as, a chicken *farm*; a fox *farm*. By extension, a tract of water reserved for the artificial cultivation of some aquatic food; as, an oyster *farm*.

WEBSTER'S NEW INT'L DICTIONARY OF THE ENGLISH LANGUAGE 919 (2nd ed. unabridged 1934, reprinted 1947; previous printings 1909-30 *passim*) (first two emphases added; remaining emphases in original; hereafter "WEBSTER'S SECOND"). (WEBSTER'S THIRD carried these latter definitions forward without any significant change, except to add "tree farm" as a further illustration. *Id.* at 824.). The relevant definitions of the transitive verb "farm" are to the same effect. The CENTURY DICTIONARY's definition states that to farm is "*[t]o cultivate, as land; till and plant.*" *Id.* at 2143 (definition 4; emphasis added). The WEBSTER'S SECOND definition is not only in accord with, but includes the substance of, that of the CENTURY DICTIONARY. WEBSTER'S SECOND states that to farm is "[t]o devote (land) to agriculture; *to cultivate, as land, to till*, as a farm; to use (land) as a farm." *Id.* at 919 (definition 5; emphasis added). The relevant definition of the transitive verb "farm" in the CENTURY DICTIONARY bears out this distinction, stating that to farm is "*[t]o cultivate, as land; till and plant.*".*Id.* at 2143 (definition 4; emphasis added). The applicable definition of the same verb in WEBSTER'S SECOND not only is in accord, but includes the substance of that of the CENTURY DICTIONARY. WEBSTER'S SECOND states that to farm is "to devote (land) to agriculture; *to cultivate, as land; to till*, as a farm; to use (land) as a farm." *Id.* at 919 (definition 5; emphasis added).

It is thus clear that farming at a minimum is the cultivation of the soil (which, under *Fleckles*, "include[es] the planting of seed [and] the harvesting of crops," 149 N.E. at 915), and can also include the raising of animals. *Ryan* explicitly recognized these concepts when it said "[t]hat the [zoning ordinance violation defendants'] raising of the crops and the livestock were *agricultural pursuits* is beyond question. *Indeed, these activities are the quintessence of farming[.]*" 560 N.E.2d at 81 (emphases added). Moreover, these are the same activities that *Fleckles*, and later *Chavez*, recognized in defining "agriculture" as " 'the art or science of cultivating the soil, including the planting of seed, the harvesting of crops, and the raising, feeding and management of live stock or poultry.'" *Chavez*, 140 N.E.2d at 502 n.1 (quoting *Fleckles*, 149 N.E. at 915 (in turn citing, *inter alia*, Webster's Dictionary)). Comparing these definitions thus makes clear the meanings of both *Fleckles*' statement that "[t]he terms 'farm employee' and 'agricultural employee' as used in this state have substantially the same meaning[,]" 149 N.E. at 915, and the implication of that statement that agriculture in Indiana is substantially equivalent to farming.

As previously discussed above, the Indiana Supreme Court recognized in *Heffner* that the legislature had acquiesced in the interpretation of the "farm or agricultural employee" exemption from the Workmen's Compensation Act in opinions such as *Fleckles* and *Chavez*. In addition, as was also explained earlier, the General Assembly in enacting a statute is presumed to be aware of existing statutes on the same subject, and the judicial interpretations of those statutes. Thus, the legislature, in enacting what became former IC § 9-1-4-41(i), and current IC § 9-29-5-13(b) and (c), in 1969 and 1991, respectively, was presumably aware both of *Fleckles* and *Chavez* and its own acquiescence in those opinions. By logical extension, the legislature was also presumably aware of, and adopted, *Fleckles*' implied substantial equating of agriculture in Indiana to farming. The wording of these statutes supports this inference. Both require that to be eligible for "farm plating," the truck, trailer or semitractor and trailer in question must be "used by the owner or guest occupant in connection with *agricultural* pursuits usual and normal to the user's *farming* operation[.]" *Id* (emphases added).

b. Scope of Agriculture as Shown by Indiana Statutory Definitions of Agriculture-Related Terms

When the General Assembly first enacted the "farm plating" statute in 1969, its awareness of related law was not restricted to the Workmen's Compensation Act and judicial opinions defining agriculture under that statute. The legislature was presumably also aware of other statutes it had previously enacted that included activities other than traditional farming in defining agriculture or agriculture-related terms. By necessary implication, agriculture includes the activities to which these terms relate.

For example, shortly before the Appellate Court decided *Fleckles*, Indiana, like many other states, had passed a Co-operative Marketing Act as a response to the then- depressed state of farm product prices. Ch. 20, 1925 Ind. Acts 42, as amended, codified at IC ch. 15-7-1 (1988 and 1993). The purposes of the act are, in relevant part, "to promote, foster, and encourage the intelligent and orderly production and marketing of *agricultural products* through cooperation;... and to make the distribution of *agricultural products* between producer and consumer as direct as can be efficiently done[.]" *Id.* subsec. 1(a), 1925 Ind. Acts at 42, as amended by ch. 34, sec. 1, 1931 Ind. Acts 79, 79, codified at IC § 15-7-1-1(a) (emphases added). As a means to these ends the act authorizes the formation of not-for-profit corporations, which the act defines as "associations," "to engage in any activity in connection with the production, marketing or selling of the *agricultural products* of its members[,]" among other activities. *Id.* sec. 4, 1925 Ind. "cts at 43, as amended by ch. 34, sec. 3, 1931 Ind. "cts 79, 80, codified at IC § 15-7-1-4 (emphasis added). The act makes, among other entities," persons engaged in the production of *agricultural products*[,]" eligible to form such associations. *Id.* sec. 3, 1925 Ind. Acts at 43, codified as amended at IC § 15-7-1-3 (emphasis added).

Given the number of times that the term "agricultural products" appears in the Indiana Co-Operative Marketing Act, and its effect on entitlement to participate in forming co-operative associations, it is not surprising that the General Assembly defined this term in the statute. That definition appears in subsec. 2(a) of the act, 1925 Ind. Acts at 43, codified at IC § 15-7-1-2(a). The legislature has amended section 2 of the act several times, including in P.L.183-1983, sec. 132, 1983 Ind. Acts 1189, 1243, which made certain technical, non-substantive amendments to IC § 15-7-1-2. However, the General Assembly has never amended the definition of "agricultural products" appearing in IC § 15-7-1-2(a), despite these repeated opportunities to do so, including in 1983. As has been previously noted, the legislature also added the "farm plating" exemption of IC § 6-6-4.1-2(b)(4) to the Motor Carrier Fuel Tax Law in 1983. Statutes enacted (or, in the case of IC § 15-7-1-2(a), re-enacted) at the same session of the General Assembly are to be interpreted *in pari materia* (*i.e.*, harmoniously). *E.g., Lutz v. Arnold*, 193 N.E. 840, 848 (Ind. 1935) (hereafter "*Arnold*"). The definition of "agricultural products" in IC § 15-7-1-2(a) thus gives a good indication of what the legislature considered agriculture to include for purposes of the "farm plating" exemption. The definition is also helpful because the delivery of agricultural products over the roads is presumably the first step in the marketing process that the Indiana Co-Operative Marketing Act was enacted to promote.

IC § 15-7-1-2(a) classifies a variety of products as being agricultural, at least when they are produced on a farm. It states that "[t]he term 'agricultural products' shall include horticultural, viticultural, forestry, dairy, livestock, grain, poultry, bee and any other *farm* products." *Id* (emphasis added). The act uses the various adjectives that describe the products included in this definition in their plain, or ordinary and usual, sense, which requires reference to dictionaries contemporary to the passage of the act in 1925 to learn their respective meanings. "Horticultural" and "viticultural" are the adjectives derived from the nouns "horticulture" and "viticulture," respectively. The CENTURY DICTIONARY defined "horticulture" as being "the cultivation of a garden; the art of *cultivating* or managing gardens[.]" *Id.* at 2894 (emphasis added). However, this definition went on to note that "[t]he ordinary productions of horticulture are generally classed under the three heads of fruits, flowers, and vegetables, *which on a large scale are cultivated separately*,...." *Id* (emphasis added). The definition thus tacitly recognized that horticulture can be vocational as well as avocational. The WEBSTER'S SECOND definition of "horticulture" described it as being "[t]he cultivation of a garden or orchard; the science and art of growing fruits, vegetables, and flowers or ornamental plants. *Horticulture is one of the main divisions of agriculture.* Cf. FLORICULTURE, VITICULTURE, OLERICULTURE." *Id.* at 1204 (emphasis added). The CENTURY DICTIONARY definition of "viticulture" called it "the culture or cultivation of the [grape]vine[,]" *id.* at 6774, going on to describe a "viticulturist" in part as "a grape-grower." *Id.* Since the grape is a fruit, and horticulture as previously defined includes the cultivation of fruit, viticulture is a form of horticulture. (Some years after passage of the Co-Operative Marketing Act, the Attorney General of Indiana confirmed substantially all of the foregoing propositions in an opinion construing another statute using the word "horticulturist." 1953 Op. Att'y Gen. No. 100, at 467. The Attorney General administratively construed " 'horticulture'... to encompass *only* the science or art of growing fruits, vegetables and flowers or ornamental plants." *Id.* at 469 (emphasis added).)

It is apparent from reviewing these various dictionary definitions that the General Assembly intended the term "agricultural products" to include the products of as many disciplines or vocations subsidiary to agriculture as possible in light of the state of agriculture in Indiana in 1925. However, the legislature's failure to amend this definition in 1983 indicated that the scope of agriculture under Indiana law either had not expanded at all in the meantime, or had expanded so little as not to require legislative attention. Although the General Assembly did enact statutes between 1925 and 1983 that linked additional vocations to agriculture, the Department will show below that these vocations are branches of disciplines that the legislature had already identified in IC § 15-7-1-2(a) as being agricultural.

For example, before it enacted the first farm plating statute in 1969, the General Assembly also had addressed agriculture for sales and use tax purposes. In 1965, the legislature had added an exemption from those taxes for tangible personal property directly consumed in the direct production in, among other activities, "agriculture, horticulture, floriculture, or arboriculture." Ch. 232, sec. 7, 1965 Ind. Acts 556, 572 (amending the Gross Retail and Use Tax Act, ch. 30, § 4, 1963 Ind. Acts (Spec. Sess.) 60, 63), recodified as amended at IC § 6-2.5-5-5.1 (1988 and 1993). Again resorting to a contemporary dictionary, in this case WEBSTER'S THIRD, "arboriculture" is defined as "the cultivation of trees and shrubs esp[ecially] for ornamental purposes[,]" while "floriculture" is "the cultivation and management usu[ally] on a commercial scale of ornamental and flowering plants[.]" *Id.* at 110 and 874, respectively. The definition of "horticulture" in WEBSTER'S THIRD is broader than that of WEBSTER'S SECOND and harmonizes with that of the CENTURY DICTIONARY previously quoted above. WEBSTER'S THIRD describes "horticulture" in relevant part as "the cultivation of an orchard, garden, *or nursery on a small or large scale*: the science and art of growing fruits, vegetables, *flowers or ornamental plants*. -- compare FLORICULTURE, OLERICULTURE, POMOLOGY." *Id.* at 1093 (emphases added).) Both arboriculture and floriculture are therefore forms of horticulture, which the definition from WEBSTER'S SECOND quoted above in turn recognized as being one of the principal branches of agriculture. (However, the previously cited Attorney General's opinion had already recognized that horticulture includes floriculture. 1953 Op. Att'y Gen. No. 100, at 469, citing *Hardin v. Vestal*, 162 S.W.2d 923, 925 (Ark. 1942)). In addition, the listing of "agriculture, horticulture, floriculture, or arboriculture[ ]" in close proximity to each other, together with the use of the disjunctive word "or," indicates that the General Assembly intended that horticulture, floriculture, and arboriculture be treated as activities that are forms of agriculture. The Indiana Supreme Court similarly construed a list of productive activities in another sales and use tax exemption statute as "overlap[ping] and at times encompass[ing] each other" in *Indiana Dep't of State Revenue v. Cave Stone, Inc.,* 457 N.E.2d 520, 524 (Ind. 1983).

The legislature elaborated on forms of existing categories of, and added subcategories of horticulture to, agriculture in 1971, when it amended former IC § 22-11-1-9 (1971) to exempt "farm service buildings" from the state building commissioner's jurisdiction to enforce building and safety regulations. P.L.No. 360, sec. 1, 1971 Ind. Acts 1471, 1471. Doing so required the General Assembly also to amend former IC § 22-11-1-1 to add a definition of the term "farm service building" as being, in relevant part, "any building or structure which is used for *agricultural purposes*[.]" P.L.No. 359, sec. 1, 1971 Ind. Acts 1468, 1468 (emphasis added; codified at IC § 22-12-1-4(c) (1988 and 1993) as an exception to the definition of "Class 1 structure"). The same act said that "the term 'agricultural purposes' means farming, dairying, pasturage, apiculture, horticulture, floriculture, vitaculture, [sic] ornamental horticulture, olericulture, pomiculture and animal and poultry husbandry[.]" *Id.* at 1468-69 (now codified as IC § 22-12-1-2). "Apiculture" is "beekeeping, esp[ecially] when pursued on a large scale[,]" WEBSTER'S THIRD at 100, and the legislature had already impliedly classified this activity as being agriculture by defining bee products as being "agricultural products" under IC § 15-7-1-2(a). "Olericulture" is "a branch of horticulture that deals with the production, storage, processing, and marketing of vegetables." WEBSTER'S THIRD at 1572. "Pomiculture" is "the art or practise of fruit-culture; pomology." FUNK & WAGNALLS NEW "STANDARD" DICTIONARY OF THE ENGLISH LANGUAGE 1926 (1958). Both olericulture and pomiculture are thus forms of horticulture as previously defined above, the products of which are also "agricultural products" under IC § 15-7-1-2(a).

The General Assembly in 1925 therefore had already formed a nearly complete opinion of what agriculture included. It did not define agriculture simply by describing it in general terms, as *Fleckles* was to do shortly thereafter. Instead, the legislature did so by referring to the products resulting from specifically described activities involving the raising and use of particular categories of domesticated animals, the cultivation of trees and of particular categories of plants. The legislature did not change its opinion in 1980 or 1983, when it respectively enacted substantially the final form of what became former IC § 9-1-4-41(i), and IC § 6-6-4.1-2(b)(4). All that the General Assembly had done in its intervening agricultural enactments was simply to make its definition of agriculture, and by extension of the agricultural vocation, more explicit.

F. "USUAL AND NORMAL TO THE USER'S FARMING OPERATION" VERSUS "COMMERCIAL ENTERPRISE": WHEN WORK IS OR IS NOT AGRICULTURAL

1. The "Independent Productive Function" Test

Notwithstanding the breadth of the previously described activities that are included in agriculture, not every kind of work, task or duty related to agriculture is agricultural. Both the federal and the Indiana appellate courts have recognized this point. In *Farmers Reservoir & Irrigation Co. v. McComb*, 69 S.Ct. 1274 (U.S. 1949) (hereafter "*Farmers Reservoir & Irrigation*"), the U.S. Supreme Court had to decide whether employees of a mutual company producing water for its farmer shareholders were exempt from the federal minimum wage laws as being "employed in agriculture[.]" (*See* Fair Labor Standards Act of 1938 (hereafter "FLSA"), subsec. 3(f) and para. 13(a)(6), 52 Stat. 1060, 1060 and 1067, now codified as amended at 29 U.S.C. §§ 203(f) and 213(a)(6) (1994), which respectively define "agriculture" and exempting persons "employed in agriculture"). In holding that the employees were not exempt, the Court succinctly observed that "the conclusion that [a type of] work *is necessary* to agricultural production does not require [saying] that it *is* agricultural production." *Id.* at 1277 (emphases in original). *Ryan* later elaborated on this point. The latter opinion held in part that the expansion of what had previously been incidental livestock dealing activities on a Monroe County farm into a stockyard business violated the county's agricultural zoning ordinance. 560 N.E.2d. at 82-83. In doing so, the panel stated that

> not all activities with an agricultural nexus are themselves agricultural. *In re Boyer* (1917), 65 Ind. App. 408, 117 N.E. 507; *Farmers Reservoir & Irrigation Co. v. McComb* (1949), 337 U.S. 755, 69 S.Ct. 1274, 93 L.Ed. 1672. In *Boyer*, the court held that an injured employee of a wheat threshing business was not an agricultural employee, but an industrial employee, eligible for workers' compensation benefits. The court found wheat threshing to be a business or industrial pursuit in and of itself entirely separate and independent of farming.... [even though wheat threshing has] to do with getting the farm product ready for consumption." *Boyer*, 65 Ind. App. at 411, 117 N.E. at 508. [*Boyer* appears to use "pursuit" in its vocational, rather than its work, sense.] In *Farmers Reservoir*, the United States Supreme Court applied the same analysis [as *Boyer*], and stated:
>
> > [F]unctions which are necessary to the total economic process of supplying an agricultural product, become, in the process of economic development and specialization, separate and independent productive functions operated in conjunction with the agricultural function but no longer part of it. Thus, *the question as to whether a particular type of activity is agricultural is not determined by the necessity of the activity to agriculture* nor by the physical similarity of the activity to that done by farmers in

> other situations. *The question is whether the activity in the particular case is carried on as part of the agricultural function or is separately organized as an independent productive activity.* [Emphases added by the Department.]

Id., quoting 69 S.Ct. at 1278. (The dictionary definition of the noun "function" coming closest to the sense in which the U.S. Supreme Court appears to have used that word is "[p]rofession [or] occupation[.]" WEBSTER'S SECOND at 1019, definition 3.)

Under *Farmers Reservoir & Irrigation* and *Ryan*, the work, task or duty in question thus must be done as part of the farmer's agricultural vocation to qualify as statutorily exempt agricultural work. The range of work that qualifies as agricultural therefore is not open-ended. If the work is done as part of a vocation that is economically independent of agriculture, that task or duty is not agricultural work, and is not entitled to statutory exemption, even though the vocation for which the work is performed is related to agriculture. The legislature is presumed to have been aware of *Farmers Reservoir & Irrigation* in 1969, when it first enacted what became former IC § 9-1-4-41(i), and in 1983, when it enacted IC § 6-6-4.1-2(b)(4). It was also presumably aware of *Ryan*, which was decided in 1990, when it recodified the "farm plating" statute in 1991 as current IC § 9-29-5-13(b) without material change. The language the General Assembly chose for the "farm plating" statutes reflects its awareness of *Farmers Reservoir & Irrigation* and *Ryan*. Both former IC § 9-1-4-41(i) and current IC § 9-29-5-13(b) require that the farm truck, farm trailer or farm semitrailer and tractor be "used in agricultural pursuits usual and normal to the [farm vehicle] user's farming operation[.]" *Id.* The Department administratively construes this language as requiring that the farm vehicle operator use that vehicle in work that is part of the owner/taxpayer's agricultural vocation. Consistently with this interpretation, the Department construes IC § 6-6-4.1-2(b)(4) and 45 IAC § 13-2-2(5) as imposing the same requirement. Farmers must have used their trucks, trailers or semitrailers and tractors in work that is part of the farmer/taxpayer's agricultural vocation, *i.e.* the taxpayer's farm operation, to claim an exemption as exempt from motor carrier fuel and surcharge taxes. However, the use of the vehicle in question falls outside the scope of the above-quoted language if it is used in a vocation that is economically independent of, and intended to generate a source of regular income for the farmer in addition to, that operation. Such a vocation is a "commercial enterprise" as former IC § 9-1-4-41(i), current IC § 9-29-5-13(c) and 45 IAC § 13-2-2(5)(C) use that phrase. During the time that a farmer uses a farm truck, farm trailer or farm semitrailer and tractor in such an enterprise, that farmer is not eligible to claim the tax exemption for any of the fuel that the vehicle consumes.

<u>2. Federal Judicial Opinions That Discuss the Occupational Status of Peat Extraction</u>

The Department has discovered two court opinions that address the issue of whether peat operations comparable to the taxpayer's are agriculture, both of which answer this question in the negative. Like *Farmers Reservoir & Irrigation,* these decisions interpreted the agricultural exemption from the FLSA. They are *Wirtz v. Ti Ti Peat Humus Co.*, 373 F.2d 209 (4th Cir. 1967) (hereafter "*Ti Ti Peat Humus.*") and *Walling v. Georgia Peat Moss Co.*, 7 Lab. Cas. (CCH) & 61,622 (M.D. Ga. 1943) (hereafter "*Georgia Peat Moss.*"). The more authoritative opinion of the two is *Ti Ti Peat Humus*, decided just two years before the General Assembly first enacted what eventually became former IC § 9-1-4-41(i). In *Ti Ti Peat Humus Co.* the employer, a South Carolina corporation engaged in the business of extracting, processing, packing and selling peat, became financially distressed and stopped paying its employees the minimum wage then in effect. The U.S. Department of Labor became aware of the situation and, through the Secretary of Labor, filed suit in federal district court in South Carolina to get an injunction requiring the employer to comply with the FLSA's minimum wage, maximum hour and record-keeping requirements. The employer defended by claiming two exemptions, one of which was the agricultural exemption of FLSA para. 13(a)(6), 29 U.S.C. § 213(a)(6) (1958).

The district court denied the injunction, holding that peat was an "agricultural commodity." 249 F.Supp. 166 (D. S.C. 1966), as discussed at 373 F.2d at 209-10. (FLSA subsec. 3(f), 29 U.S.C. § 203(f) defines agriculture in relevant part as "includ[ing] the cultivation and tillage of the soil,... [and] the... cultivation, growing, and harvesting of any *agricultural or horticultural commodities*[.]" *Id* [emphasis added]). The Secretary appealed the district court's denial of the injunction to the United States Court of Appeals for the Fourth Circuit, which reversed the district court's decision and remanded the case to that court with instructions to enter the injunction. 373 F.2d at 213.

The Court of Appeals, in describing the activities involved in the employer's operation, said "that the company had not planted or cultivated any growing plants which would contribute to the accumulated vegetation in the bog." 373 F.2d at 211. After addressing another issue, the Fourth Circuit observed that

> [t]he administrative treatment of peat indicates that it is not an agricultural commodity. In 1943 the Administrator of the Wage and Hour Division declared that the term 'agricultural and horticultural commodities' means 'commodities which are planted and cultivated by man,' and 'since peat is not such a commodity the exemption does not apply to employees engaged in extracting, processing and distributing peat moss.' [Footnote omitted.]
>
> The Secretary points out that as early as 1940 northern peat marketers applied for, and were granted an exemption from the [FLSA] under section 7(b)(3) which exempts certain 'seasonal industries.'... [T]he fact that such an exemption was sought is strong evidence indicating that neither Congress nor the peat industry considered the agricultural exemption applicable.

Id (citing in the omitted footnote CCH Lab. Law Rep., Wages-Hrs., & 25,243.73; emphasis added by this Department). The Court of Appeals noted that the language of a 1949 amendment to the FLSA made it appear that Congress had adopted this administrative interpretation and "intended that peat should not fall within the agricultural exemption." 373 F.2d at 212.

The Court of Appeals noted that in ruling to the contrary the district court had declined to follow *Georgia Peat Moss Co.* 373 F.2d at 212. Instead, the district court had relied on *Premier Peat Moss Corp. v. United States*, 147 F.Supp. 169 (S.D.N.Y. 1956) (three-judge court) (hereafter "*Premier Peat Moss.*"), *aff'd per curiam without opinion sub. nom. Interstate Commerce Comm'n v. Premier Peat Moss Corp.*, 78 S.Ct. 16 (1957), discussed below, which is also one of the two opinions on which the present taxpayer relies. The Fourth Circuit distinguished *Premier Peat Moss.* as having been decided under a different statute with different objectives than the FLSA. 373 F.2d at 212. Instead, the Court of Appeals applied the "independent productive function" analysis of *Farmers Reservoir & Irrigation*. After discussing that opinion, 373 F.2d at 212-13, the Fourth Circuit said:

> In applying this test to the instant case we are fully cognizant of the relationship of peat to agriculture but *the conduct of defendant's business is independent of any agricultural activity or farming* and we find in these circumstances support for our ultimate conclusion that there is no entitlement here to the agricultural exemption.
>
> Similarly, in McComb v. Super-A Fertilizer Works, 165 F.2d 824, [(1948)], the [United States Court of Appeals for the] First Circuit Held that employees who manufactured and packed a chemical fertilizer used in agriculture were not engaged in agriculture within the meaning of section 13(f) of the [FLSA]. This decision was expressly approved by the Supreme Court in *Farmers Reservoir*, supra, 337 U.S. 755, 69 S.Ct. 1274. After announcing the above-quoted test, Chief Justice Vinson said:
>
> > "The farmhand who cares for the farmer's mules or prepares his fertilizer is engaged in agriculture. But the maintenance man in a power plant and the packer in a fertilizer factory are not employed in agriculture, even if their activity is necessary to farmers and replaces work previously done by farmers. The production of power and the manufacture of fertilizer are independent productive functions not agriculture." [69 S.Ct. at 1278.]
>
> While peat is primarily a soil conditioner and not a fertilizer, and while it is harvested and collected rather than manufactured, the rationale of these cases is persuasive, particularly so when considered in conjunction with the stated policy of the [FLSA], the legislative history and the subsequent administrative and congressional treatment.
>
> Therefore, we hold that the company is not entitled to the benefit of the claimed exemption and must comply with the minimum wage, overtime and record-keeping requirements of the [FLSA].

Id. at 213 (emphasis added). The part of the definition of "agricultural or horticultural commodities" discussed in *Ti Ti Peat Humus* has not substantively changed, although it now includes some additional detail that is relevant for present purposes. The current definition reflects a grammatical correction, including "commodities that are planted and cultivated by man[.]" 29 CFR § 780.112 (1999). More significantly, it also states that "[t]he term does not include commodities produced by industrial techniques, *by exploitation of mineral wealth or other natural resources, or by uncultivated natural growth*. For example, peat humus or peat moss is not an agricultural commodity. *Wirtz v. Ti Ti Peat Humus Co.*, 373 F(2d) 209 (C.A.4)." *Id* (emphasis added).

3. Humans Must Cultivate Plants For Their Harvesting
To Be A Usual and Normal Agricultural Pursuit.

This construction of the phrase "agricultural or horticultural commodities" in FLSA subsec. 3(f) as meaning those that are planted and cultivated by humans, and as excluding minerals, natural resources and uncultivated natural growth, is consistent with the common law of property. At common law products of the earth were divided between "crops" or "*fructus industriae*" on one hand and naturally occurring vegetation or "*fructus naturales*" on the other. "The distinction between annual crops, merely vegetable productions of the soil, raised by labor bestowed during the year, and trees, fruits and grass, which are, to a greater or less extent, of spontaneous growth, may be said to be well recognized and firmly established by the authorities." *Evans v. Hardy*, 76 Ind. 527, 532 (1881). *Lindley v. Kelly*, 42 Ind. 294 (1873) (hereafter "*Lindley*"), had previously explained this basic difference in more detail as follows:

> The distinction between the annual productions of the earth which are produced by annual planting, cultivation, and labor and such as are not, is stated with great clearness and accuracy by Mr. Chief Justice ROBERTSON, in Craddock v. Riddlesbarger, 2 Dana, [32 Ky.] 205 [(1834)], where he says: "Although such annual productions or fruits of the earth as clover, timothy, spontaneous grasses, apples, pears, peaches, cherries, etc., are considered as incidents to the land in which they are nourished, and are, therefore, not personal, nevertheless, every thing produced from the earth by annual planting, cultivation and labor, and which is therefore denominated, for the sake of contradistinction, *fructus industriae*, is deemed personal and may be sold, as personalty, even whilst growing and immature. And the purchaser of such an article in such a growing state will have the consequential right of ingress and egress, for purposes of cultivation, preservation and removal, though he will have acquired no interest in the land itself, nor any other control or dominion over it, than such as may be necessarily incident to his right to the growing *fructus*.["]

Id. at 305.

The Department has not found any statutory evidence indicating the General Assembly has ever intended to change the common law requirement that a crop arise from vegetation cultivated by humans, rather than from naturally occurring vegetation. That evidence also indicates that the legislature intended the requirement of cultivation by humans to apply under the "farm plating" statutes and the "farm-plated vehicle" exemption from motor carrier fuel and surcharge taxes.

In 1963, the General Assembly enacted the Uniform Commercial Code (hereafter "the UCC"), ch. 317, 1963 Ind. Acts 539, now codified at IC art. 26-1. As enacted the UCC included subsection 9-109(3) (1963 Ind. Acts at 719-20, now codified as IC § 26-1-9-109(3)), which defines "farm products." That statute is part of UCC Article 9--Secured Transactions, which governs personal property and fixtures acting as collateral. IC § 26-1-9-109(3) defines "farm products" in relevant part as including "crops or livestock *used or produced in farming operations*" and requires that such goods be Ain the possession of a debtor "engaged in raising,... or other *farming operations*." *Id* (emphases added). The use of this language necessarily implies that to qualify as a farm product, humans must have cultivated the vegetation constituting a putative crop.

In 1969 the General Assembly amended this definition to state that farm products are not fixtures, but otherwise left it unchanged. Ch. 72, 1969 Ind. Acts 159, 159-60. This substantial re-enactment of UCC 9-109(3) occurred in the same session in which the legislature passed the predecessor of what eventually became former IC § 9-1-4-41(i). As the Department has previously noted, statutes enacted at the same session of the legislature must be interpreted harmoniously with each other. *Arnold, supra*, 193 N.E. at 848. Former IC § 9-1-4-41(i) therefore also requires that for vegetation or products of vegetation to be a crop, humans must have cultivated that vegetation.

Two statutes enacted in 1983, the same year in which IC § 6-6-4.1-2(b)(4) was enacted, indicate that the General Assembly still requires that humans cultivate crops. The first of these was P.L.183-1983, sec. 132, 1983 Ind. Acts 1189, 1243. As discussed earlier, that statute made certain technical amendments to IC § 15-7-1-2(a), but left the substance of that subsection's definition of "agricultural [including horticultural] products," including the equating of that term with "farm products[,] *id.*, unchanged. The second statute was P.L.186-1983, sec. 1, 1983 Ind. Acts 1252, 1252, codified at IC ch. 15-4-9 (1988 and 1993), which created a quality certification mechanism for an "agricultural product" as defined by what is now IC § 15-4-9-1. That provision defines an agricultural product as being "any plant or part of a plant or plant byproduct lawfully *grown* in Indiana." *Id* (emphasis added).

The reference to growth in IC§ 15-4-9-1 and the lack of substantive change to IC § 15-7-1-2(a) indicate that the legislature has never changed Indiana common law as far as to make natural vegetation not adapted to cultivation, or its products, into farm products. Under Indiana law the terms "agricultural products," "farm products" and "horticultural products" include only a finite number of plants, plant parts or plant byproducts. Specifically, these terms include only those annual plants that had been considered *fructus industriae* at common law, those categories of *fructus naturales* that humans have adapted to cultivation, *e.g.* trees, flowers, vegetables, shrubs and perennials, and the harvestable parts and byproducts of each. They do not include categories of *fructus naturales* that humans have not adapted to cultivation, such as naturally occurring peat.

<u>4. Harvesting Naturally Occurring Peat Is Not a Usual and Normal Agricultural Pursuit.</u>

a. Naturally Occurring Vegetation Is an Interest in Land at Common Law.

The General Assembly has never changed the common law rule, set out in the above quotation from *Lindley*, that naturally occurring vegetation is considered to be real property because it is part of the land on which it grows. Another Indiana Supreme Court opinion makes this point more succinctly, stating that

> "[l]and comprehendeth, in its legal signification, any ground, soil, or earth whatsoever, as meadows, pastures, woods, moors, waters, *marshes*, furzes, and heath. It has also in its legal signification an indefinite extent, upwards as well as downwards." 1 Cruise Dig. 54. See 1 Inst. 4; 4 Bl. Com. 18; 3 Kent. Com. 402.

Owens v. Lewis, 46 Ind. 488, 508 (1874) (emphasis added; hereafter "*Owens*").

b. Unsevered, Naturally Occurring Peat Is A Product of Naturally Occurring Vegetation and an Interest in Land At Common Law.

As was noted in the Statement of Facts, the taxpayer's farm abuts a marsh. The relevant definition in WEBSTER'S THIRD defines a "marsh" as being "a tract of soft *wet land*: FEN, SWAMP, MORASS[.]" *Id.* at 1385, definition 1 (emphasis added). Peat is defined in relevant part by another English language dictionary in general use as being "a highly organic material found in marshy or damp regions composed of partially decayed *vegetable matter*[.]" RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 1427 (2d ed. unabridged 1987) (emphasis added). It therefore would seem that Indiana common law would classify Unsevered, naturally occurring peat, like other naturally occurring vegetation, as being land rather than personal property, *i.e.* a crop or an agricultural or horticultural product.

An early Indiana worker's compensation opinion involving coal mining on a farm, viewed in the context of the chemical and geological relationship between coal and peat, indirectly confirms this point. *Hanna v. Warren*, 133 N.E. 9 (Ind. App. 1921) (hereafter "*Hanna*"), is a pre-*Fleckles* decision in which a farmer had a surface outcropping of coal on his farm. He and two other family members contracted with a third party and entered into business among themselves to sell as much coal from this outcropping as they could deliver to that party at a local railroad switch. (With the exceptions of this and one prior, brief removal of coal from this outcropping, the farmer had never engaged in any vocation other than farming.) The sellers performed this contract by blasting coal out of this outcropping and delivering it to the switch in the farmer's wagons, but discontinued the operation after only about a month because the market price of coal fell below production costs. However, in the brief time it was active, an employee working at the coal operation was injured. That employee applied to the Industrial Board for worker's compensation and received an award, which his employers challenged in the Appellate Court. That court's summary of their principal argument, and the court's response to it, read as follows:

> Appellants contend that they are farmers, and as such are not subject to the Workmen's Compensation Laws, [citation omitted]. This contention cannot prevail. At the time of the accident and for several weeks prior thereto appellants were mining and loading coal under an agreement.... *Appellants while engaged in this work were not engaged in farm labor as that term is generally understood. They were at the time of the accident and injury to appellee engaged in the mining business*, and subject to the provisions of the Workmen's Compensation Laws[.]

Id. at 10 (emphasis added).

If mining is not farming, then under the analysis of *Fleckles* set out above mining also is not agriculture as practiced in Indiana; it does not involve "cultivating the soil, *including the planting of seed [and] the harvesting of crops[.]*" 149 N.E. at 915 (emphasis added). In other words, the farmer did nothing to the land on his farm to bring the coal in the outcropping into existence. The coal already existed as part of the land a result of a natural process, specifically the coalification process that the United States Supreme Court described just recently in *Amoco Prod. Co. v. Southern Ute Indian Tribe*, 119 S.Ct. 1719, 1724 (U.S. 1999). As the Department understands the coalification process, it begins with peat and, if uninterrupted by humans, proceeds through lignite and bituminous coal to anthracite coal. *See* WEBSTER'S THIRD's definitions of "anthracite," "bituminous coal," "lignite" and "peat" at 92, 223, 1309 and 1662, respectively.

If coal mining is not agriculture, then neither is the extraction or severing of any naturally occurring peat from which coal may ultimately develop. If neither coal nor unsevered, naturally occurring peat is a farm product or crop, *i.e.* personal property, then by process of elimination both must be real property. The Indiana Supreme Court so held as to coal in *Cypress Creek Coal Co. v. Boonville Mining Co.*, 142 N.E. 645, 648 (Ind. 1924). An opinion from another state that is consistent with *Owens*' definition of "land" as quoted above confirms the same point as to peat. In *Clarke v. Alstores Realty Corp.*, 527 P.2d 698 (Wash. Ct. App. 1974) (hereafter "*Clarke*"), a subsidiary of the defendant corporation entered into a contract with the plaintiff to have him remove peat that was in place on a tract of real estate that the defendant owned. The contract gave the plaintiff the right to enter onto the real estate, remove peat from and stockpile peat on it for two years, and also gave the plaintiff title to any peat he removed. The corporate parent reserved the right to cancel the contract on six months' notice, but did not communicate this condition to the plaintiff until it actually gave that notice. The plaintiff refused to vacate and the corporate parent removed him and his equipment from the real estate, after which the plaintiff sued the corporate parent for breach of contract, misrepresentation and conversion of the stockpiled peat. The defendant asserted as an affirmative defense that the contract failed to comply with the content requirements of Washington's statute of frauds governing writings purporting to convey of interests in real estate, and the trial court granted the defendant summary judgment on that basis. (At the time the events of the case occurred Washington had not yet adopted the UCC, including UCC § 2-107, which now provides the test for determining whether "timber, minerals or the like," *id.*, is real or personal property. 527 P.2d at 701.)

In affirming, the Court of Appeals said:

> Although no Washington case has been brought to our attention which characterizes the sale of peat in place as the sale of an interest in realty, we agree with the trial court's ruling on the point. *The peat grew naturally upon the land, unaided by human efforts. At common law, vegetation which grew from perennial roots without the aid of human care and cultivation was regarded as "fructus naturales," and, while unsevered from the soil, was considered as pertaining to realty. Severe v. Gooding*, 43 Idaho 755, 254 P. 1054 (1927) (wild grass and herbage); *Webb v. Arrington*, 249 Md. 46, 238 A.2d 243 (1968)

(sod) (*compare Barron v. Edwards*, 45 Mich.App. 210, 206 N.W.2d 508, 509-510 (1973) (cultivated sod, grown as a crop, treated as personalty)); *Kirkeby v. Erickson*, 90 Minn. 299, 96 N.W. [705,]705-706 (1903) (wild grass); *Sparrow v. Pond*, 49 Minn. 412, 52 N.W. 36 (1892) (blackberries); *In re Chamberlain*, 140 N.Y. 390, 35 N.E. 602 (1893) (grass).

Id (footnote omitted; emphasis added).

c. Unsevered, Naturally Occurring Peat Is Also Land For Various Statutory Purposes.

Various statutory and regulatory schemes for land use also treat unsevered, naturally occurring peat as an interest in land. For example, naturally occurring peat is considered to be an element of the value of land in some non-regulatory statutory situations. For example, *Dillenbeck v. State*, 83 N.Y.S.2d 308 (N.Y. Ct. Cl. 1948), an eminent domain opinion, holds that the existence of a peat deposit is an element of Fifth Amendment just compensation if there is a market demand for that peat. Similarly, *McMurray v. Commissioner*, 985 F.2d 36, 41 (1st Cir. 1993) held that the value of a charitable gift of a bog containing a peat deposit had to reflect state and local legal restrictions (*e.g.*, zoning legislation and the need to obtain a permit, discussed below) on the development of any possible peat extraction operation.

If one wishes to extract or sever naturally occurring peat or engage in filling operations incident to that activity, that person may be required by statute or ordinance to obtain a permit from the appropriate unit or agency of government first. Zoning ordinances of local government units are one (and perhaps the oldest) such permitting system, as illustrated in *Rhod-A-Zalea & 35th, Inc. v. Snohomish County*, 959 P.2d 1024 (Wash. 1998). However, the most notable such permitting scheme affecting peat extraction is that for discharges of pollutants into the nation's navigable waters (including wetlands) under section 404 of the Federal Water Pollution Control Act Amendments of 1972, Pub. L. 92-500, sec. 2, 86 Stat. 816, 884, as amended by the Clean Water Act of 1977, Pub. L. 95-217, subsecs. 67(a) and (b), 91 Stat 1566, 1600, codified as 33 U.S.C. § 1344 (1988 and 1994) (hereafter "the CWA"). Congress enacted the permitting system of CWA section 404 under its power to regulate interstate commerce under U.S.CONST. art. I, § 8, cl. 3. *E.g., United States v. Byrd*, 609 F.2d 1204, 1209-11 (7th Cir. 1979) (hereafter "*Byrd*").The stated purpose of this system is " 'to restore and maintain the chemical, physical and biological integrity of the Nation's waters.'" 33 U.S.C. § 1251(a), quoted in *United States v. Huebner*, 752 F.2d 1235, 1239 (7th Cir. 1985) (hereafter "*Huebner*").The permitting scheme has been interpreted as protecting the entire aquatic system of the United States. *See Byrd*, 609 F.2d at 1209-10 and 1210 n.6, and authorities there cited. Detailed discussions of this permitting system as it affects peat extraction may be found in *Michigan Peat Div. v. U.S. Envtl. Protection Agency*, 175 F.3d 422, 423-25 (6th Cir. 1999) and *Huebner, supra*, 752 F.2d at 1239-41. These opinions indicate that Congress chose as the means to its stated end a permitting scheme to regulate the discharge of dredge and fill material from wetlands (including those on which peat naturally occurs), which feed the country's waters. The U.S. Army Corps of Engineers, the U.S. Environmental Protection Agency (hereafter "the EPA"), and in a few jurisdictions state environmental agencies, administer this system. This scheme is similar to the traditional system adopted in local zoning ordinances permitting variances in the use of land.

Eight years after enacting the CWA, Congress also began to make federal protection available to all wetlands vulnerable to conversion to agricultural production, whether or not they are part of the nation's waters. Title XII of the Food Security "ct of 1985, Pub. L. 99-198, 99 Stat. 1354, 1504 (hereafter "the FSA"), codified at 16 U.S.C. § 3801 *et seq*. (1988 and 1994), created what is popularly known as the "Swampbuster" provision, FSA § 1221, 99 Stat. at 1507, codified at 16 U.S.C. § 3821. Congress enacted Swampbuster pursuant to its spending power under U.S. CONST. art. I, § 8, cl. 1. Swampbuster therefore differs from the direct regulation of wetlands under the CWA because Swampbuster can indirectly reach additional wetlands that do not affect interstate commerce. *United States v. Dierckman*, 41 F.Supp.2d 870, 874 (S.D. Ind. 1998) (hereafter "*Dierckman I*"), *aff'd* 201 F.3d 915, 922-23 (7th Cir. 2000) (hereafter "*Dierckman II*").

"By enacting the FSA, Congress intended to 'discourage the draining and cultivation of wetland that is unsuitable for agricultural production in its natural state.' S. Rep. No. 99-145 at 303 (1985), *reprinted in* 1985 U.S.C.C.A.N. 1103, 1969." *Dierckman II*, 201 F.3d at 917. The U.S. Department of Agriculture (hereafter "the USDA") has also administratively interpreted Swampbuster as being "designed to remove the incentive that certain benefits provided by the [USDA] could give producers... to convert wetlands for the purpose of producing an agricultural commodity." Department of Agriculture, Highly Erodible Land and Wetland Conservation, Interim Rule, 51 Fed. Reg. 23496, 23496 (1986), codified as amended at 7 CFR Part 12 (1987-2000). The removal of such incentives is also the stated purpose of the USDA regulations that determine a farmer's ineligibility under Swampbuster for farm program benefits. 7 CFR § 12.1(b).

As originally enacted, Swampbuster stated that "following December 23, 1985 [the date of passage of the FSA], any person who in any crop year produces an agricultural commodity on converted wetland shall be ineligible" to participate for that year in a wide variety of federal agricultural programs. *Id* (Title 16 U.S.C. § 3801(a) defines the terms "agricultural commodity," "converted wetland," "wetland" and terms that each of these definitions in turn use.) However, experience proved the original Swampbuster to be inadequate to Congress' stated purpose. *See generally* Anthony N. Turrini, *Swampbuster: A Report From the Front*, 24 IND. L. REV. 1507 (1991). The most obvious shortcoming of the original version of Swampbuster was its scope: the disqualification was only for one year, and the statute imposed that sanction only on persons who produced agricultural commodities on converted wetland, not on persons who actually converted wetland to agricultural use.

Congress has tried to address these deficiencies by amending Swampbuster twice. The first amendment was Title XIV, § 1421(b) of the Food, Agriculture, Conservation, and Trade Act of 1990, Pub. L. 101-624, 104 Stat. 3359, 3572 (hereafter

"FACTA"). Congress did so again in Title III, § 321 of the Federal Agriculture Improvement Reform Act of 1996, Pub. L. 104-127, 110 Stat. 888, 986-87 (hereafter "FAIRA"), effective July 3, 1996 by virtue of *id.* § 326, 110 Stat. at 992. These amended versions of Swampbuster were in effect for most of the taxpayer's investigation period, especially the 1990 version. As the Department will explain below, the taxpayer's description of his actions in getting prior approval from SCS to extract peat show that the taxpayer knew about and was trying to comply with these amended versions of Swampbuster. The taxpayer's actions also show that the taxpayer knew that naturally occurring peat is an interest in land rather than an "agricultural commodity," which 16 U.S.C. § 3801(a)(1) defines in relevant part as being "*planted and produced... by annual tilling of the soil*,...." *Id* (emphasis added).

Congress in FACTA redesignated the original Swampbuster provision as 16 U.S.C. § 3821(a) and added a new subsection (b). As it read during most of the investigation period, the latter provision stated that

> any person who in any crop year beginning after November 28, 1990 [the date of passage of FACTA], converts a wetland by draining, dredging, filling, leveling, or any other means for the purpose, or to have the effect, of making the production of an agricultural commodity possible on such converted wetland shall be ineligible for those payments, loans, or programs specified in subsections (a)(1) through (3) of this section for that crop year and all subsequent crop years.

16 U.S.C. § 3821(b) (Supp. II 1990 and 1994). "The more recent [FACTA] provision does not require that the person actually produce crops on the converted wetland, only that they [sic] converted the wetland for that purpose." *Dierckman I*, 41 F.Supp.2d at 872. Congress in FAIRA redesignated subsection (b) as 16 U.S.C. § 3821(c) (Supp. III 1997), changed the programs to which the ineligibility sanction attaches and relocated the revised list of programs to subsection (b). FSA § 1221 as amended by FAIRA sec. 321, 110 Stat. at 986-87. However, Congress left the language imposing the actual ineligibility sanction on converters of wetlands substantially unchanged. *Id.*

The administrative procedure for determining compliance with or exemption from Swampbuster, and farm benefit program ineligibility, that the USDA had in effect during most of the taxpayer's investigation period was codified in 7 CFR Part 12 (1990-96). *Dierckman II* described that procedure as follows:

> The ineligibility determination under the Swampbuster provisions involves multiple agencies within the USDA. The *Soil Conservation* Service (SCS) determines whether a wetland or converted wetland exists on a particular farm and whether production of a crop is possible on any converted wetland. See 7 CFR § 12.6(c) [(1994)]. The initial SCS determination is made by the district conservationist. The district conservationist's decision is [administratively] appealable.... After the SCS makes its technical determination regarding the existence or conversion of a wetland, another USDA agency, the Agricultural Stabilization and Conservation Agency (ASCS) [sic], determines whether any exemptions apply to the conversion of the wetland. See 7 CFR § 12.6(b). The ASCS then determines the eligibility of any farmer who applies to the ASCS for USDA farm benefits. See 7 CFR § 12.6(a). These ASCS determinations are first made by an ASCS county committee. An [administrative] appeal can be taken.... See 7 CFR § 12.6(b).

201 F.3d at 918 (footnotes omitted; emphasis added). The Department of Agriculture Reorganization Act of 1994, Pub. L. 103-354, Title II, 108 Stat. 3209 (hereafter "DARA"), changed this administrative scheme to some extent. Specifically, DARA authorized the Secretary of Agriculture to create, and to reassign Swampbuster compliance responsibilities to, new agencies, and also mandated more closely coordinated enforcement of Swampbuster within USDA and with other federal wetlands programs. Section 246 of DARA, 108 Stat. at 3223-25, codified at 7 U.S.C. § 6962 (1994, corrected Supp. I 1995), authorized the Secretary to create the Natural Resources Conservation Service (hereafter "NRCS") and to transfer to it jurisdiction over Swampbuster, among other programs. *Id.* subsec. (a), 108 Stat. at 3223, codified at 7 U.S.C. § 6962(a); *id.* para. (b)(5), 108 Stat. at 3224, formerly codified at 7 U.S.C. § 6962(b)(5) (recodified by FAIRA sec. 336(d)(2)(A)(ii), 110 Stat. at 1006, as 7 U.S.C. § 6962(b)(3)), respectively. DARA section 246 also repealed the enabling legislation for SCS. *Id.* para. (f)(1), 108 Stat. at 3225, repealing former 16 U.S.C. § 590e (1988). Section 226, 108 Stat. at 3214-16, codified at 7 U.S.C. § 6932 (1994, corrected Supp. I 1995), authorized the Secretary to create the Consolidated Farm Service Agency (hereafter "CFSA" or "FSA") and gave it jurisdiction over agricultural price and income support, production adjustment and agricultural credit programs, among other functions. *Id.* subsec. (a) and paras. (b)(1) and (b)(3), respectively, all at 108 Stat. 3214, codified as 7 U.S.C. § 6932(a), (b)(1) and (b)(3), respectively. On October 20, 1994, one week after DARA became law, the Secretary created and transferred to CFSA and NRCS the respective responsibilities of ASCS for farm benefit programs and of SCS for soil and water conservation, and abolished both ASCS and SCS. Department of Agriculture, Department Reorganization Notice, 59 Fed. Reg. 66517, 66518 and 66519 (published Dec. 27, 1994), respectively. CFSA and NRCS exercised their respective duties as they affected Swampbuster, as described below, for the remainder of the taxpayer's investigation period, and continue to do so at this writing.

In addition to creating CFSA, DARA section 226 also assigned it initial jurisdiction over any administrative appeals of Swampbuster determinations, including technical (*e.g.*, wetland and wetland conversion) determinations by NRCS. *Id.* para. (d)(1), 108 Stat. at 3215, codified as 7 U.S.C. § 6932(d)(1). However, that statute further requires CFSA to coordinate review of technical determinations with NRCS and any other federal agencies with wetland responsibilities whenever required by law or any inter-agency memorandum of agreement. *Id.* para. (d)(2), 108 Stat. at 3215, codified as 7 U.S.C. § 6932(d)(2). (The memorandum to which the statute refers is the January 6, 1994 Memorandum of Agreement (hereafter "MOA") entered into among the Departments of Agriculture, the Army and the Interior, and the EPA, to coordinate administration of the CWA section 404, Swampbuster and other federal wetland laws. *See* Department of Agriculture, Highly Erodible Land and Wetland Conservation, Interim Rule, RIN 0578-AA17, 61 Fed. Reg. 47019, 47022, corrected 61 Fed. Reg. 53491 (1996), codified at 7 CFR Part 12 (1997-2000) (hereafter "7 CFR Interim Part 12"), which discusses the MOA.)

USDA promulgated 7 CFR Interim Part 12 in part to implement FAIRA's amendments to Swampbuster and in part to "make[ ] several changes to interpret, clarify, or specify procedures followed in the implementation for the... [wetland conservation] provisions [of the FSA, as amended]." 61 Fed. Reg. at 47021. An implied part of the latter effort was the coordination that DARA had mandated of Swampbuster and other federal wetland programs. The basic division of labor between FSA and NRCS under 7 CFR Interim Part 12, which is consistent with DARA § 226(d)(1) and (d)(2) as discussed above, is set out in 7 CFR § 12.6(b) and (c), respectively. The responsibilities of NRCS concerning wetlands are set out in detail in *id.* § 12.30. Paragraph (a)(8) of the latter regulation requires NRCS to give an opportunity to participate in the implementation of Swampbuster to the Army Corps of Engineers, the EPA and the U.S. Fish and Wildlife Service (an Interior Department agency; see 16 U.S.C. § 742b(b) (1994)). In addition, 7 CFR § 12.30(c) requires NRCS to agree to procedures (*e.g.*, the MOA) for certifying wetland determinations and delineations with those agencies. DARA § 226(d) and 7 CFR Interim Part 12 thus lead the Department to infer that the federal government has intended since at least 1994 to consistently treat peat occurring naturally on wetlands as exactly that, *wet land* as indicated in the definition of "marsh" from WEBSTER'S THIRD quoted above.

The taxpayer's explanation at the protest hearing of the legal prerequisites to entitlement to extract peat from under the farm shows a clear working knowledge of and sensitivity to federal policy concerning wetland, and in particular to the consequences of conversion of wetland by a farmer. Before beginning to extract peat from under any part of the farm, the taxpayer always obtained the prior consent of the former SCS (now NRCS). The taxpayer, in addition to referring to Wetlands (W), also mentioned Prior Converted Wetlands (PC), Minimal Effect Wetlands (MW), and Farmed Wetlands (FW), and said that he could extract peat only from fields that the SCS had identified as being MW or PC. Either Swampbuster itself or the regulations now used to administer it exempt all three of the latter classifications of wetlands from the benefits ineligibility ban. The PC and MW exemptions have existed since Swampbuster was first enacted. 16 U.S.C. § 3822(b)(1)(A); FSA § 1222(c), 99 Stat. at 1508, originally codified as 16 U.S.C. § 3822(c), recodified as *id.* (f)(1) (Supp. II 1990) by FACTA sec. 1422, 104 Stat. at 3574, respectively. USDA added the FW exemption in 7 CFR Interim Part 12. *See id.* §§ 12.2 and 12.5(b)(1)(iii), which respectively define and give a limited exemption to farmed wetland. The taxpayer also recognized the need for a permit from the Corps of Engineers (*i.e.*, under CWA section 404) to extract peat from wetlands and farmed wetlands.

In short, the taxpayer's explanation indicates that the taxpayer understood, at least for purposes of Swampbuster and the CWA, that the naturally occurring peat under the farm was not an agricultural commodity as defined in 16 U.S.C. § 3801(a)(1), but a component of wetland. If nothing else, the taxpayer's pains to get the approval of the former *Soil Conservation* Service before severing the peat, to remain eligible for federal farm program benefits, would have put the taxpayer on actual notice of the legal status of that peat. The current claim that it was an agricultural or farm commodity is thus inconsistent with the taxpayer's earlier actions and what the taxpayer learned, or should have learned, from those actions.

d. Some Statutes Treat Unsevered, Naturally Occurring Peat As If It Were A Mineral.

Whether unsevered, naturally occurring peat is legally treated as being not just land, but also a mineral, and its extraction or severance as being mining or quarrying, depends to some extent on the statutory or other legal context in which the question arises. *United States v. Toole*, 224 F. Supp. 440 (D. Mont. 1963) (hereafter "*Toole*"), the other opinion on which the taxpayer relies, held that purported placer claims that certain individuals had filed for a peat bog in a national forest were invalid. The specific issue, *id.* at 443, was whether peat was a "valuable mineral deposit[ ]" as that phrase is used in 30 U.S.C. § 22, which authorizes the exploration, occupation and purchase of federal lands on which such deposits exist. The court quoted *Premier Peat Moss* for the propositions that peat is vegetable in origin and that its transformation into coal had not progressed far enough for peat to be considered a mineral. 224 F. Supp. at 446, quoting 147 F. Supp. at 174. After analyzing other authorities, the district court in *Toole* held that peat was not a valuable mineral deposit because it was not a locatable and purchasable mineral under the general federal mining statutes. 224 F. Supp. at 449.

Whether the district court's rationale in *Toole* was a correct interpretation of 30 U.S.C. § 22 in particular, that rationale appears to the Department to have been at least questionable under federal mining law in general, both as it existed at the time and today. Title 30 U.S.C. § 3, which except for a technical amendment in 1992 was last amended in 1913, states that the former United States Bureau of Mines of the Department of the Interior has the duties, among others,

> to investigate explosives and peat; *and on behalf of the Government to investigate the mineral fuels and unfinished mineral products belonging to, or for the use of, the United States, with a view to their most efficient mining, preparation, treatment, and use*; and to disseminate information concerning these subjects in such manner as will best carry out the purposes of the provisions of [other specified] sections... of this title[.]

Id (emphasis added). Pursuant to these statutory mandates to investigate and disseminate information concerning peat, the Bureau of Mines at the time of *Toole* published information on peat. This information appeared, among other places, in an annual publication entitled the "*MINERALS* YEAR BOOK." (Emphasis added). (This publication continues to be issued to the present day. The United States Bureau of Mines did so until its elimination in federal fiscal year 1996, at which time the United States Geological

Survey succeeded to this responsibility.

The district court in *Toole* held that neither 30 U.S.C. § 3 nor the government's publishing activities concerning peat were enough to justify classifying it as a mineral. 224 F. Supp. at 448-49. However, the court's quotation of the statute, *id.* at 448, stopped after the word "peat" and omitted the language following it emphasized above, leaving its quotation and analysis of the statute incomplete. It is arguable that, whatever the specific legal status of peat on national forest lands might be, for purposes of the general mining laws it is a "mineral fuel[or] unfinished mineral product[ ]" as 30 U.S.C. § 3 uses these terms. The statute certainly is open to this interpretation, given that peat historically has been used as fuel and that, as the district court in *Toole* recognized, the formation of peat is the first step in the coalification process.

Implicit in the preceding discussion is the fact that opinions like *Toole* are issued to interpret laws affecting mineral rights on federal lands, usually in the West, that the government was either trying to get settlers to homestead or that it chose to keep for itself. *See generally Southern Ute Indian Tribe*, 119 S.Ct. at 1722-23 and *Watt v. Western Nuclear, Inc.*, 103 S.Ct. 2218, 2220-21 and 2225-27 (U.S. 1983) (hereafter "*Western Nuclear*"), which discuss the history of that legislation. Those statutes "may be a matter of considerable importance in the semiarid lands of the West, but [they are] of much less importance to the rest of the Nation."*Western Nuclear*, 103 S.Ct. at 2238 (1983) (Stevens, J., dissenting). Aside from being enacted to deal with a specific problem in a specific geographic area, these statutes provide no guidance in this protest (with the possible exception of 30 U.S.C. § 3, as explained above) for the additional reason that Congress enacted them in the late nineteenth and early twentieth centuries. For example, the statute in issue in *Western Nuclear* was passed in 1916, while those involved in *Southern Ute Indian Tribe* were enacted in 1909 and 1910. The statute specifically at issue in *Toole*, 30 U.S.C. § 22, was passed in 1872. Ch. 152, § 1, 17 Stat. 91. These statutes therefore do not necessarily reflect whether a given substance would be considered a "mineral" under the modern popular (as distinguished from scientific) definition of that word. As the Department will explain below, the commonly accepted meaning of "mineral" has expanded in modern times. Thus, 30 U.S.C. § 22 does not reflect one of the definitions of that word that had come into contemporary use by the time that the General Assembly enacted the "farm plating" statute in 1969. For these reasons, the Department believes that *Toole* does not state a generally applicable rule of law. Opinions such as *Toole* and *Western Nuclear* are valid authority only in the specific legal and factual (including geographical) contexts in which they arose.

In contrast to the limited statutory systems at issue in *Toole* and *Western Nuclear*, federal agencies charged with administering laws of general applicability throughout the country treat peat as being a mineral, or at least as being mineral-like, and its extraction as being mining. For example, the Department of Labor today classifies peat and peat humus extraction activities of the kinds at issue in *Ti Ti Peat Humus* and this protest as being not agriculture, but "Mining and Quarrying of [Miscellaneous] Nonmetallic Minerals, Except Fuel." Standard Industrial Classification Manual, Industry Group 1499 (1987).

e. Unsevered, Naturally Occurring Peat Is Depletable.

In addition, the Internal Revenue Code (hereafter "the Code") and Treasury Regulations treat unsevered, naturally occurring peat, like coal, as being a natural deposit or mineral and grant a depletion allowance of five percent of the gross income from the peat, excluding rents or royalties paid in respect of it. I.R.C. §§ 611(a) and 613(a) and (b)(6) (1988 and 1994); 26 CFR (Treas. Reg.) § 1.613-2(a)(1)(v) (1961-99). *A. Duda & Sons, Inc. v. United States*, 560 F.2d 669 (5th Cir. 1977), discusses the history of the peat depletion allowance. This opinion documents that the IRS, its administrative predecessors in interest, and Congress have considered peat to be a depletable natural deposit since at least 1918, if not from the inception of the modern federal income tax. *Id.* at 674-75. The IRS promulgated the depletion regulations on peat currently in effect in 1960. T.D. 6446, 1960-1 C.B. 208, 25 Fed. Reg. 482 (1960). The promulgated regulations included all substances depletable under I.R.C. § 613 and the regulations promulgated thereunder in its definition of "minerals," and implemented the statutory five-percent depletion allowance for peat. *Id.*, 1960-1 C.B. at 213 and 231, 25 Fed. Reg. at 483 and 490, now codified as Treas. Reg. §§ 1.611-1(d)(5) and 1.613-2(a)(1)(v), respectively. (This inclusion of peat in the regulatory definition of "minerals" was consistent with one contemporary understanding of that word. WEBSTER'S THIRD defines "mineral" in relevant part as being "any of various naturally occurring homogeneous or apparently homogeneous and usu[ally] but not necessarily solid substances (as ore, coal,... [and] *peat*,...." *Id.* at 1437, definition 1 b (emphasis added)). The General Assembly is presumed to have been aware of the law on depletion, as well as the IRS' promulgation in 1960 of the regulations concerning peat, when in 1963, only three years later, it passed the Adjusted Gross Income Tax Act (hereafter "the AGIT Act"). Ch. 32 (Spec. Sess.), 1963 Ind. Acts 82, codified as IC chs. 6-3-1 to -7 (1988 and 1993).

G. NATURALLY OCCURRING PEAT, OR OTHER NATURALLY OCCURRING VEGETATION, IS NOT AN AGRICULTURAL OR FARM PRODUCT UNDER THE "FARM PLATING" STATUTES OR THE MOTOR CARRIER FUEL TAX LAW.

1. The Legislature Has Never Changed the Legal Status of Naturally Occurring Peat.

Given this reliance on federal income tax law, the Department finds it unlikely that the General Assembly intended to deprive peat, or any other depletable substance, of its longstanding eligibility for the depletion allowance for state income tax purposes when it passed the AGIT Act. Moreover, as previously discussed above, the legislature has declined on three different occasions to change the common law status of naturally occurring vegetation not adapted to cultivation, including naturally occurring peat, from real to personal property, *i.e.* crops or farm products. It did not do so earlier in 1963 when it enacted the UCC, in 1969 when it enacted the forerunner of former IC § 9-1-4-41(i) and current IC § 9-29-5-13(b), or in 1983 when it added IC § 6-6-4.1-2(b)(4) to the Motor

Carrier Fuel Tax Law. Thus, as previously discussed, the General Assembly has not changed the status of such vegetation as being land under Indiana's common law. In addition, the legislature is presumed to have been aware of *Ti Ti Peat Humus* and *Hanna* when it first enacted the modern farm plating statute. In light of this circumstance and the foregoing legislative record, the Department cannot reasonably interpret either that statute or IC § 6-6-4.1-2(b)(4) as making naturally occurring peat or any other depletable mineral, natural deposit or naturally occurring timber, an agricultural, horticultural or farm product. To interpret these statutes to the contrary would obliterate the distinction between agriculture on one hand, and mining, quarrying or lumbering (as distinguished from forestry) on the other. Such a result would not affect just the relatively limited number of farmer taxpayers in Indiana with natural deposits of peat on their farms. It would also affect a much larger group of farmer taxpayers, mostly located in southern and western Indiana, whose farms include substantial deposits of coal or other depletable minerals, natural deposits or timber.

2. The Court Opinions On Peat That the Taxpayer Has Cited Are Not on Point.

The two opinions that the taxpayer has cited to the Department concerning peat are not persuasive. The Department has already discussed one of these opinions, *Toole*, in detail above and incorporates that discussion by reference as though fully set out here. However, the Department would further observe at this point that the taxpayer, by citing *Toole*, is implying that if peat is not a mineral, it must be an agricultural, farm or horticultural product. Even if *Toole* applied to this protest (a proposition which the Department has already denied), the taxpayer's implied conclusion would not follow.

Nor does *Premier Peat Moss.*, the other opinion on which the taxpayer relies, convince the Department that naturally occurring peat is an agricultural, horticultural or farm product. That opinion did hold that peat moss fell within the exemption for motor vehicles carrying "agricultural (including horticultural) commodities (not including manufactured products thereof)" in the Motor Carrier Act of 1935 (Interstate Commerce Act, Title II), 49 Stat. 543. *Id.*, paragraph 203(b)(6), 49 Stat. at 545, then codified as amended at 49 U.S.C. § 303(b)(6) (1952), now recodified as further amended at 49 U.S.C. § 13506(a)(6) (1994). The Department that the taxpayer's certification or exemption from certification as a common or contract motor carrier is not at issue in this protest. That body of law thus provides at best analogous, rather than direct, authority for resolving the present issue. With that said, the Department believes that *Premier Peat Moss* does not support the taxpayer's position in the present protest for several reasons.

First, the district court in *Premier Peat Moss* made its holding notwithstanding the fact that it recognized that peat moss is a "product of nature[.]" 147 F. Supp. at 172. The court did not discuss the status of such unsevered naturally occurring vegetation as being *fructus naturales* and an interest in land, rather than a crop and personal property, under the common law of the United States (including Indiana). The fact that the peat forming the subject of *Premier Peat Moss* was imported rather than domestic explains this glaring omission. Given that circumstance, the parties had little incentive to argue, and the district court little incentive to discuss, the issue carefully. Had the peat been domestic instead, the district court's analysis of this subject might have been more thorough and it might have reached a different conclusion.

Second, if the plaintiffs had been peat extractors hauling that peat in interstate commerce, they would have been subject to a different exemption that had developed prior to *Premier Peat Moss.* Paragraph 203(a)(17) of the Motor Carrier Act of 1935, 49 Stat. at 545, formerly codified at 49 U.S.C. § 303(a)(17) (1976) and id. § 10102(16) (1994) (repealed 1995), defined the term "private carrier of property by motor vehicle" as being

> any person not included in the terms "common carrier by motor vehicle" or "contract carrier by motor vehicle", who or which transports in interstate or foreign commerce by motor vehicle property of which such person is the owner, lessee, or bailee, when such transportation is for the purpose of sale, lease, rent, or bailment, or in furtherance of any commercial enterprise.

Id. Federal tribunals construing this definition had held well before *Premier Peat Moss* that private carriers did not need a certificate or permit from the former Interstate Commerce Commission (hereafter "the ICC") to operate in interstate or foreign commerce. *E.g., ICC v. Tank Car Oil Corp.*, 151 F.2d 834 (5th Cir. 1945). The leading pre-*Premier Peat Moss* opinion on this subject was *Lenoir Chair Co.*, 51 M.C.C. 75 (1949), *aff'd sub nom. Brooks Transportation Co. v. United States*, 93 F. Supp. 517 (E.D. Va. 1950) (three-judge court), *aff'd without opinion at* 71 S.Ct. 501 (1951) (hereafter "*Lenoir Chair*"). *Lenoir Chair* had held that there was no need to obtain ICC authorization if " 'the *primary business* of an operator is found to be manufacturing or some other noncarrier *commercial enterprise*,....' " 51 M.C.C. at 75 (emphases added), quoted in *Red Ball Motor Freight, Inc. v. Shannon*, 84 S.Ct. 1260, 1262 (U.S. 1964) (hereafter "*Red Ball Motor Freight*"). As a result of *Lenoir Chair* the test for entitlement to this exemption became known as the "primary business" test. If the plaintiffs in *Premier Peat Moss* had been engaged in the primary business of peat extraction and were hauling that peat in interstate or foreign commerce incident to their respective operations, paragraph 203(a)(17) rather than paragraph 203(b)(6) of the Motor Carrier Act would have applied. The district court instead would have applied the "primary business" test to the plaintiffs' respective operations, and granted the "private carrier" exemption to the transportation of their peat, as these opinions had developed that test and exemption up to that time.

Third, the facts of *Premier Peat Moss* and the motor carrier authority exemption applicable as a result, differ from the facts of this protest and the exemption that would be applicable if the taxpayer had been acting as a farmer concerning the peat. Unlike the taxpayer, the plaintiffs in *Premier Peat Moss* were contract carriers. The exemption applicable in *Premier Peat Moss* used general language; it referred to "agricultural (including horticultural) commodities (not including manufactured products thereof)[.]" 49 U.S.C. § 303(b)(6) (1952). However, in contrast to the plaintiffs in *Premier Peat Moss.*, the taxpayer has claimed throughout this protest to be acting as a farmer concerning the peat deliveries. Assuming without admitting that the taxpayer was acting as a farmer for purposes of this discussion, the taxpayer would have been eligible for the separate exemption from intrastate motor carrier regulation for farmers (hereafter "the farmer's intrastate authority exemption"). This exemption was codified during the investigation period at IC § 8-2.1-18-3 (Supps. 1989-92 and 1993) and IC § 8-2.1-24-3(4)(A) (Supp. 1995). As it has read since 1989, the statute exempts motor vehicles "controlled and operated by any farmer when used in the transportation of the farmer's agricultural commodities *and products of those commodities* or in the *transportation of supplies to the farm*[.]" P.L.99-1989, sec. 9, 1989 Ind. Acts 1012, 1023 (emphases added). The Department's research shows that it is modeled on paragraph 203(b)(4a) of the Motor Carrier Act of 1935, 49 Stat. at 545 (currently recodified as amended at 49 U.S.C. § 13506(a)(4)). As originally enacted, that paragraph exempted "motor vehicles controlled and operated by any farmer when used in the transportation of his agricultural commodities *and products thereof*, or in the transportation of *supplies* to his farm[.]" 49 Stat. at 545 (emphases added).

A direct comparison reveals that the language of the farmer's intrastate authority exemption is substantially narrower and more specific than that of the paragraph 203(b)(6) exemption at issue in *Premier Peat Moss.* Unlike the latter statute, the farmers' intrastate authority exemption draws an explicit distinction between "agricultural commodities *and products of those commodities*" on one hand and "*supplies [transported] to the farm*" on the other. IC § 8-2.1-18-3 (Supps. 1989-92 and 1993) and IC § 8-2.1-24-3(4)(A) (Supp. 1995). The reference to "supplies" suggests the farmer must transport them for use at the beginning of, or during, the farmer's own agricultural production process. Thus, under either exemption the carrier would be entitled to haul peat for use at some time thereafter in a farming or horticultural operation. However, if the carrier were also a farmer or horticulturist, the peat would have to be intended for use in that farmer or horticulturist's own operation for the farmer's intrastate authority exemption to apply.

In contrast, the reference to "products" implies the transportation of both the commodities from which the products derive and the products themselves occurs at the end, rather than the beginning of, or during, the agricultural production process. It further implies that the farmer transporting those commodities or products must have done something in the farmer's operation, either directly or indirectly (*e.g.* cultivation), to bring the cargo into existence. By contrast, a farmer hauling naturally occurring peat to sell to a non-farmer has done nothing in the farmer's own operation to cultivate the peat being hauled. A farmer in the taxpayer's situation would not be entitled to claim the intrastate authority exemption, even if the peat were ultimately intended for resale to some other farm or horticultural operation. That exemption is thus more restrictive than that at issue in *Premier Peat Moss.*, and as a result that opinion would not be applicable if this were a motor carrier authority case.

Fourth, unlike the exemption in *Premier Peat Moss*, but like the farmer's intrastate authority exemption, entitlement to farm plates in Indiana depends on whether or not the entity causing the motor vehicle to be operated is using that vehicle incident to agriculture. As previously discussed above, the Department interprets the noun phrase "agricultural pursuits" in the farm plating statutes in the sense of agricultural work or labor. It also interprets that phrase, as modified by the adjectival phrase "usual and normal to the [farm motor vehicle] user's farming operation," consistently with the "independent productive function" test set out in *Farmers Reservoir & Irrigation*. and *Ryan*. The motor vehicle in question therefore must be operated, and the fuel in that vehicle must be consumed, in work or labor that is part of the farmer's operation or vocation for that vehicle and fuel to be respectively entitled to Indiana farm plates and the farm exemption from motor carrier fuel and surcharge taxes. To repeat an earlier quotation from *Farmers Reservoir & Irrigation*, "the conclusion that [a type of] work *is necessary* to agricultural [including horticultural] production does not require [saying] that it *is* agricultural [or horticultural] production." *Id.*, 69 S.Ct. at 1277 (emphases in original). Specifically, the fact that naturally occurring peat is extracted or severed *for use in* agriculture (including horticulture) does not *make* that activity agriculture or horticulture, or the severed peat a cultivated agricultural or farm product. The farmer must have done something to cultivate the vegetation constituting the cargo. This is exactly the conclusion that *Ti Ti Peat Humus.* reached under *Farmers Reservoir & Irrigation* and FLSA, subsection 3(f), which similarly requires human work or labor, specifically "*cultivation, growing, and harvesting*" of the commodity for it to be agricultural or horticultural. *Id* (emphases added). It is thus the holding of *Ti Ti Peat Humus.,* and not that of *Premier Peat Moss*, that is more consistent with the "farm plating" statutes, and IC § 6-6-4.1-2(b)(4) and 45 IAC § 13-2-2(5) as well.

<u>3. A Farmer Must Have Cultivated the Plants From Which a Motor Vehicle's Cargo Is Derived For Transportation Of That Cargo To Be A Usual and Normal Agricultural Pursuit.</u>

The Department must administer the Motor Carrier Fuel Tax Law and the Surcharge Tax Act in light of Indiana common law, and consistent with the AGIT Act so as to produce a harmonious taxation scheme. The Department therefore construes IC § 6-6-4.1-2(b)(4) and 45 IAC § 13-2-2(5) to require a farmer causing deliveries of cargo of, or derived from, vegetation to the first point of sale in motor vehicles eligible for farm plating to have cultivated that vegetation in a farming operation. Such cargoes would fit the definitions of "agricultural product" or "farm product" as the law has come to understand those terms. Its deliveries to the first point of sale would be "agricultural pursuit[s] usual and normal to the user's farm operation." By extension, the fuel consumed in such deliveries would be exempt from the motor carrier fuel and surcharge taxes by virtue of IC § 6-6-4.1-2(b)(4) and 45 IAC § 13-2-2(5).

<u>4. Whether Transporting A Cargo Derived From Naturally Occurring Vegetation Is A Usual and Normal Agricultural Pursuit Depends on the Purpose of the Transportation.</u>

However, the result may differ if the cargo is or derives from uncultivated vegetation or timber, or is a deposit, that occurs naturally on the farm from which it came. Such a deposit, and such vegetation or timber, would be either an interest in land under

Indiana common law, depletable under the Code, or both. If that is the case, then the entitlement to the exemption would depend on the purpose for the extraction or severance. For example, a farmer's purpose for doing so may be to use a natural deposit on the farm in furtherance of the farming operation. Examples of such use would include gravel for a service road or water for irrigation. *See Western Nuclear*, 103 S.Ct. at 2228 n.14 and cases there cited and *Mumma Bros. Drilling Co. v. Department of Revenue*, 411 N.E.2d 676, 677-78 (Ind. Ct. App. 1980) (gravel and water, respectively). Another purpose would be to conserve existing farmland. (*Compare* I.R.C. § 175, which allows farm taxpayers to deduct soil or water conservation expenses incurred in connection with land used in farming.) If the farmer can prove such a purpose, then fuel consumed by a motor vehicle eligible for farm plating that transported such a cargo on Indiana public highways incident to such activity would be "usual and normal to the [farm motor vehicle] user's operation" and tax exempt. If, however, the purpose is to bring previously unfarmed land into cultivation or pasturage, then the consumption would not be "usual and normal" and the fuel consumed incident to that activity would be taxable. *Cf.* 40 CFR § 232.3(c)(1) (1988-99) and *Huggett v. Department of Natural Resources*, 590 N.W.2d 747, 751 (Mich. Ct. App. 1998) *cause cont'd* -- N.W.2d --, Table No. 113463 (Mich., Jul. 5, 2000) which respectively state that the farming exemptions from the CWA and Michigan's Wetlands Protection Act do not apply to activities necessary to create new farmland. (The process of reclaiming wetland containing peat in particular is coincidentally known as "sur charging." *Molargik v. West Enters., Inc.*, 605 N.E.2d 1197, 1198 (Ind. Ct. App. 1993) Thus, fuel consumed in hauling peat incident to sur charging would be, appropriately, subject to surcharge tax.) Lastly, if the farmer's purpose is to generate a source of regular income in addition to that of the farm operation, the deliveries of the severed vegetation, timber or deposit to the point of sale also are not "usual and normal" to that operation. Instead, those activities would constitute a prohibited independent "commercial enterprise" and the exemption would be unavailable. The motor vehicles would be "commercial motor vehicles" if they otherwise meet the requirements of IC §§ 6-6-4.1-1(b) and -2(a), and the fuel consumed in making the deliveries would be taxable.

G. APPLICATION OF ANALYSIS TO TAXPAYER'S PROTEST

The requirement that an "agricultural pursuit" be "usual and normal to the [farm vehicle] user's farming operation" (hereafter the "usual and normal" test) is the key to deciding this protest. If the raw peat extraction and delivery work was performed as part of the taxpayer's agricultural vocation, then that work would have been usual and normal to the taxpayer's farm operation, and thus "agricultural pursuits" under the "farm plating" statutes. The trucks used to deliver that peat therefore would have qualified for farm plating; by definition, they would not have been "commercial motor vehicles" for purposes of the Motor Carrier Fuel Tax Law and the Surcharge Tax Act. By extension, the taxpayer would not have been a "carrier" subject to the Surcharge Tax Act.

However, if the peat operation was economically independent of the taxpayer's farm operation, even if necessary to "agriculture," then the deliveries of that peat were not agricultural work "usual and normal" to that operation. If the latter situation is the case, then the taxpayer was engaged in a "commercial enterprise" as former IC § 9-1-4-41(i), current IC § 9-29-5-13(c) and 45 IAC § 13-2-2(5)(C) use that term. The trucks the taxpayer used to deliver the peat would no longer have been "qualified to be registered and used as" farm trucks, in violation of IC § 6-6-4.1-2(b)(4) as interpreted in 45 IAC § 13-2-2(5)(A), when the taxpayer began to use them in that enterprise. At that point they would have become "commercial motor vehicles." The taxpayer would have become a "carrier" and those trucks' fuel consumption subject to motor carrier fuel surtax.

The present taxpayer is in the same legal position as the employer was in *Ti Ti Peat Humus.* Both the taxpayer and the employer were engaged in peat extraction activities. The taxpayer did not create the bog out of which the peat under the taxpayer's farm came, and did not cultivate any plants to add to that marsh until *after* completing the extraction of the peat from under a given parcel of that farm. The taxpayer admitted at the protest hearing that the peat under his farm, like that forming the subject of *Ti Ti Peat Humus*, occurred naturally. His use of a disker to reach the peat did not constitute cultivation of the soil; diskers are commonly used in the extraction of reed-sedge peat such as that involved in this protest. RAYMOND L. CANTRELL, U.S. DEP'T OF THE INTERIOR, BUREAU OF MINES, MINERALS YEARBOOK VOLUME I, METALS AND MINERALS: PEAT, 833, 836 (1990)..More importantly, the taxpayer planted no seed incident to the extraction, the planting of seed being a key component of the legal definition of "agriculture" in Indiana. *Fleckles*, 149 N.E. at 915. That peat therefore was not an agricultural or horticultural crop or product, contrary to the taxpayer's present contention. Moreover, the taxpayer's conscientious efforts to comply with Swampbuster during the investigation period indicate that the taxpayer recognized that the peat was not an "agricultural commodity" as Swampbuster defines that term. Instead, the peat was an interest in land under Indiana common law, and was also depletable under I.R.C. §§ 611(a) and 613(a) and (b)(6) and Treas. Reg. § 1.613-2(a)(1)(v) for income tax purposes.

The taxpayer also admitted that he did not and does not use the peat he extracts to use on his own farm to grow any horticultural crops and that peat cannot be used to grow any other agricultural crops. Nor is there any evidence before the Department that the taxpayer engaged in his peat extraction and delivery activities for soil conservation reasons. For that matter, there is no evidence that the taxpayer engaged in those activities for any reason other than to generate a source of regular income in addition to that which his farm operation provided. In this connection, the Department notes that the taxpayer's farm is located in a county in Indiana that the federal government has recognized as being one of those in which for-profit peat extraction and severance activities take place. WANDA J. WEST, U.S. DEP'T OF THE INTERIOR, BUREAU OF MINES, MINERALS YEARBOOK VOLUME II, AREA REPORTS: DOMESTIC, THE MINERAL INDUSTRY OF INDIANA 187, 188 (1990).

It follows from the foregoing facts that the deliveries of that peat incident to its sale to the local processing plant were not "agricultural pursuits usual and normal to [the taxpayer's] farm operation" under former IC § 9-1-4-41(i) and current IC § 9-29-5-13(b). Instead, the farm-plated trucks making those deliveries were being "operated either part-time or incidentally in the conduct of a commercial enterprise" in violation of former IC § 9-1-4-41(i), current IC § 9-29-5-13(c) and 45 IAC § 13-2-2(5)(C). For that reason, the special fuel that those trucks consumed was not exempt under IC § 6-6-4.1-2(b)(4).

FINDING

The taxpayer's protest is denied as to this issue.

II. Motor Carrier Fuel Surcharge Tax – Imposition –"Carrier" Status

DISCUSSION

IC § 6-6-4.1-1(a) defines a "carrier" as being "a person who operates or causes to be operated a *commercial motor vehicle* on any highway in Indiana." *Id* (emphasis added). As discussed under Issue I above, the trucks that the taxpayer used to deliver his peat incident to its sale to a local processing plant no longer qualified for the "farm-plated vehicle" exemption of IC § 6-6-4.1-2(b)(4) and 45 IAC § 13-2-2(5). They were being were being "operated either part-time or incidentally in the conduct of a commercial enterprise" in violation of former IC § 9-1-4-41(i), current IC § 9-29-5-13(c) and 45 IAC § 13-2-2(5)(C), and fell within the definition of "commercial motor vehicle" in IC § 6-6-4.1-1(b). By operating those vehicles on Indiana highways, the taxpayer in turn became a "carrier" as the previous quotation of IC § 6-6-4.1-1(a) defines that word.

FINDING

The taxpayer's protest is denied as to this issue.

III. Motor Carrier Fuel Surcharge Tax – Imposition

DISCUSSION

IC § 6-6-4.1-4.5(a) imposes the surcharge tax "on the consumption of motor fuel *by a carrier* in its operations on highways in Indiana." The Department found under Issue II that the taxpayer was a carrier concerning the operation of the trucks used to deliver his peat incident to its sale to a local processing plant. All of the motor fuel consumed was subject to surcharge tax.

FINDING

The taxpayer's protest is denied as to this issue.

IV. Motor Carrier Fuel Surtax-Imposition – Estoppel Against /Waiver of Assessment

DISCUSSION

The taxpayer contends that an employee of the Indiana Department of Transportation and an employee of the Indiana State Police each advised the taxpayer during the investigation period that he was not liable for any motor carrier fuel tax or surcharge tax. The taxpayer argues that these representations should prevent the Department from assessing him for surcharge tax.

The Department has considered and rejected this argument in connection with its ruling on the negligence penalty issue in the taxpayer's earlier special fuel tax protest. Title 45 IAC § 15-3-2(e), which was in effect throughout the taxpayer's investigation period, clearly states that "[o]ral opinions or advice will not be binding upon the Department." The regulation draws no distinction between Departmental and non-Departmental state employees. The oral opinion of two non-Departmental state employees is no substitute for a letter ruling obtained from the Department pursuant to 45 IAC § 15-3-2(d). Under that regulation such rulings, or letters of findings treated as if they were such rulings, are the only official opinions on which a taxpayer is entitled to rely concerning the tax status of an activity.

FINDING

The taxpayer's protest is denied as to this issue.

V. Penalties

DISCUSSION

The statutes governing motor carrier fuel tax and surtax penalties varied during the investigation period. The general penalty statutes of the Tax Administration Act (P.L.61, sec. 1, 1980 Ind. Acts 660, 660, codified as amended at IC art. 6-8.1) in effect during the investigation period were IC § 6-8.1-10-2 (Supp. 1990) and IC § 6-8.1-10-2.1 (Supp. 1991 and 1993). The former statute was repealed and replaced with the latter by P.L.1-1991, secs. 69 and 70, 1991 Ind. Acts 1, 59 and 59-61, respectively, both effective April 23, 1991 by virtue of *id.* sec. 224, 1991 Ind. Acts at 191. In addition to these two statutes, however, P.L.60-1990, sec. 9, 1990 Ind. Acts 1508, 1513-14, added IC § 6-6-4.1-23 (Supps. 1990-91 and 1993), a penalty statute specifically applicable under the Motor Carrier Fuel Tax Law. IC § 6-6-4.1-23 took effect January 1, 1991 by virtue of P.L.60-1990, sec. 16, 1990 Ind. Acts at 1518. Thus, IC § 6-8.1-10-2 was the only penalty statute in effect during calendar year 1990 of the investigation period. IC § 6-6-4.1-23 was in concurrent effect with IC § 6-8.1-10-2 for the period beginning January 1, 1991 and ending April 22, 1991, and with IC § 6-8.1-10-2.1 for the part of the investigation period that occurred on and after April 23, 1991.

However, the relevant substantive criteria for deciding whether the Department should impose or waive a negligence penalty on a motor carrier fuel tax or surcharge tax assessment remained constant. IC § 6-8.1-10-2(a) imposed, and IC § 6-6-4.1-23(a)(3) imposes, a penalty for "incur[ring], upon examination by the department, a deficiency... due to negligence[.]" *Id.* IC § 6-8.1-10-2.1(h) (Supp. 1991 and 1993) (now *id.*(i) (1998)) made the actions that trigger a penalty under subsection (a) of that statute, among other subsections, inapplicable to a motor carrier fuel tax return. IC § 6-6-4.1-23(a) thus became the exclusive authority controlling that subject once IC § 6-8.1-10-2.1 took effect. Because IC § 6-6-4.1-23 does not apply to the first year of the investigation period and because it has never had any provision for waiving penalties, IC §§ 6-8.1-10-2(d) and -2.1(d) continue to govern that subject.

Each imposes a standard of “reasonable cause.” *Id.*

Title 45 IAC § 15-11-2(b), which defines “negligence,” states in relevant part that “[i]gnorance of the listed tax laws, *rules and/or regulations* is treated as negligence.” *Id* (emphasis added). When the General Assembly passed the AGIT Act in 1963 it incorporated all sections of the I.R.C. necessary to make the AGIT Act effective and made all relevant federal Treasury Regulations also regulations of this Department. Ch. 32 (Spec. Sess.), sec. 117, 1963 Ind. Acts at 85, codified as amended as IC § 6-3-1-17 (1988) and IC § 6-3-1-11(b) (1993).I.R.C. §§ 611(a) and 613(a) and (b)(6) and Treas. Reg. § 1.613-2(a)(1)(v), which govern peat depletion, were all in effect before the legislature passed the AGIT Act. The Department believes it is reasonable to infer from the taxpayer’s failure to claim the peat depletion allowance that the taxpayer had actual or constructive knowledge that naturally occurring peat is an interest in land. However, assuming the taxpayer did not have such actual knowledge, his ignorance of I.R.C. §§ 611(a) and 613(a) and (b)(6) and Treas. Reg. § 1.613-2(a)(1)(v) was negligent. An awareness of those authorities would have put the taxpayer on notice that naturally occurring peat is a natural deposit in land and not a crop or agricultural or farm product. The taxpayer has not provided any evidence that would establish reasonable cause to abate the penalty.

FINDING

The taxpayer’s protest is denied as to this issue.

DEPARTMENT OF STATE REVENUE

04970458.LOF

LETTER OF FINDINGS NUMBER: 97-0458 RST
Sales and Use Tax
For Years 1994 through 1996

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department’s official position concerning a specific issue.

ISSUES

I. Use Tax – Calculation of Use Tax Liability

Authority: Ind. Code § 6-2.5-3-2

The taxpayer protests the method employed by the auditor in calculating the use tax liability.

II. Use Tax – Liability for Use Tax on Purchases of Pest Control and Fumigation Supplies

Authority: Ind. Code § 6-2.5-5-3; Ind. Code § 6-2.5-5-5.1; Ind. Admin. Code tit. 45, r. 2.2-5-8; Indiana Department of State Revenue v. RCA Corporation, 310 N.E.2d 96 (Ind. App. 1974)

The taxpayer protests the assessment of use tax on its purchases of pest control and fumigation supplies.

III. Use Tax – Liability for Use Tax on Purchases of Forklift Repair Parts and Fuel

Authority: Ind. Code § 6-8.1-5-1

The taxpayer protests the assessment of use tax on its purchases of forklift repair parts and fuel.

IV. Use Tax – Liability for Use Tax on Purchases of Safety Gloves, Aprons, and Boots

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-8

The taxpayer protests the assessment of use tax on its purchases of gloves, aprons, and boots.

V. Use Tax – Liability for Use Tax on Purchases of Terry Cloth Gloves

Authority: Ind. Code § 6-2.5-5-3

The taxpayer protests the assessment of use tax on its purchases of terry cloth gloves.

VI. Use Tax – Liability for Use Tax on Purchases of Boiler Compound and Water Softener Salt

Authority: Ind. Code § 6-2.5-5-5.1; Ind. Admin. Code tit. 45, r. 2.2-5-10; Ind. Admin. Code tit. 45, r. 2.2-5-12

The taxpayer protests the assessment of use tax on its purchases of boiler compound and water softener salt.

VII. Use Tax – Liability for Use Tax on Purchases of UPC and Product Labels

Authority: Ind. Code § 6-2.5-5-6

The taxpayer protests the assessment of use tax on its purchases of UPC and product labels.

VIII. Use Tax – Liability for Use Tax on Purchases of Fan Motors and Fan Repair Parts

Authority: Ind. Code § 6-2.5-5-3; Ind. Admin. Code tit. 45, r. 2.2-5-8

The taxpayer protests the assessment of use tax on its purchases of fan motors and fan repair parts.

IX. Use Tax – Liability for Use Tax on Purchases of Mothballs

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-16

The taxpayer protests the assessment of use tax on its purchases of mothballs.

X. Use Tax – Liability for Use Tax on Purchases of Miscellaneous Production Supplies and Equipment

Authority: Ind. Code § 6-2.5-5-3; Ind. Admin. Code tit. 45, r. 2.2-5-8; Ind. Admin. Code tit. 45, r. 2.2-5-10

The taxpayer protests the assessment of use tax on its purchases of miscellaneous production supplies and equipment.

XI. Use Tax – Calculation of Exempt Portion of Taxpayer's Purchase of Warehouse Carts

Authority: Ind. Code § 6-8.1-5-1

The taxpayer protests the calculation of the exempt portion of its purchase of warehouse carts.

XII. Use Tax – Liability for Use Tax on its Purchases of Materials Used in Construction of Bleach Facility Buildings

Authority: Ind. Admin. Code tit. 45, r. 2.2-4-21; Indiana Department of Revenue Sales Tax Bulletin #9 (Apr. 1992)

The taxpayer protests the assessment of use tax on its purchases of materials used in construction of bleach facility buildings.

XIII. Use Tax – Liability for Use Tax on Purchases of Photographs and Photographic Services

Authority: Ind. Code § 6-2.5-3-2; Ind. Admin. Code tit. 45, r. 2.2-4-2; Indiana Department of Revenue Sales Tax Bulletin #34 (Apr. 4, 1983); Indiana Department of Revenue Sales Tax Bulletin #46 (July 11, 1983)

The taxpayer protests the assessment of use tax on the entire purchase price of photographs.

XIV. Use Tax – Liability for Use Tax on Purchases of Computer Software

Authority: Indiana Department of Revenue Sales Tax Bulletin #8 (Feb. 9, 1990)

The taxpayer protests the assessment of use tax on its purchases of computer software.

STATEMENT OF FACTS

The taxpayer is an Indiana company engaged in the business of manufacturing, and selling at wholesale, dried flowers for floral arrangements and decorations. The taxpayer receives shipments of flowers from the United States and other countries. The flowers are dried, bleached, painted, weighed, and packaged. The flowers are then either stored at the taxpayer's Indiana facility, shipped to its warehouses in Texas or Washington, or shipped directly to its customers. The taxpayer also manufactures display racks which are sold in retail transactions. A sales and use tax audit was completed on May 12, 1997, covering the years 1994 through 1996.

I. Use Tax – Calculation of Use Tax Liability

DISCUSSION

The taxpayer calculated use tax to be remitted during the audit period by taking a percentage of certain, non-production-related, ledger accounts. The percentage used by the taxpayer was based on the percentage used in a sampling projection done by a Department of Revenue auditor during a prior audit of the taxpayer for the period 1991-1993. In the current audit, the auditor examined all invoices for the audit period. The taxpayer maintains that the auditor did not give proper credit for taxes paid on purchases previously reported by the taxpayer. The taxpayer argues that this resulted in making the use tax liability greater than what the taxpayer calculated it should have been.

"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." Ind. Code § 6-2.5-3-2(a).

The auditor examined 100% of the taxpayer's invoices for the audit period. The taxpayer was allowed credit for all sales tax paid, but the taxpayer was not given proper credit for previously reported use tax paid.

FINDING

The taxpayer's protest is sustained.

II. Use Tax – Liability for Use Tax on Purchases of Pest Control and Fumigation Supplies

DISCUSSION

The taxpayer purchased insecticides and bird repellant to protect the horticultural products it receives and processes. The taxpayer was assessed use tax on these purchases. The taxpayer maintains that spraying/fumigating the horticultural products is the first step in the production process and, therefore, its purchases of insecticides and bird repellant are exempt from use tax.

The taxpayer cites Ind. Code § 6-2.5-5-3(b): "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property."

To qualify for the exemption, manufacturing machinery, tools, and equipment must have "an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property." Ind. Admin. Code tit. 45, r. 2.2-5-8(c).

The taxpayer maintains that the insecticide and bird repellant are directly used in the direct production of tangible personal property, that is, the dried flowers it sells for use as floral arrangements and decorations.

When the taxpayer directly applies insecticides and bird repellant to its products, the applicable statute is Ind. Code § 6-2.5-5-5.1(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.

By spraying the insecticides and bird repellant directly onto the products the taxpayer manufactures, the insecticides and bird repellant are consumed in the direct production of the products and, thus, are exempt.

Any insecticides or bird repellant used to control pests in the area where the products are manufactured, and not directly applied to the products, are not exempt. Ind. Code § 6-2.5-5-5.1 does not apply because the insecticides and bird repellant are not consumed in the direct production of the products. In addressing the taxpayer's argument that the manufacturing exemption of Ind. Code § 6-2.5-5-3 is the applicable statute, the RCA case is instructive. In the RCA case, the court found that air conditioning equipment was not tax exempt even though it was deemed to be essential for the economical manufacture of television picture tubes. Indiana Department of State Revenue v. RCA Corporation, 310 N.E.2d 96, 98 (Ind. App. 1974). The RCA court found that the air conditioning equipment was not directly used in the direct production of tangible personal property; that its immediate effect was not on the product itself but on the surroundings in which the manufacturing process took place. Id. at 100. In the instant case, insecticides and bird repellant not directly applied to the products have an immediate effect only on the surroundings in which the taxpayer manufactures its products, not on the products themselves. Insecticides and bird repellant not directly applied to the products are not directly used in the direct manufacture of the taxpayer's products and are not exempt.

FINDING

The taxpayer's protest is partially sustained and partially denied.

III. Use Tax – Liability for Use Tax on Purchases of Forklift Repair Parts and Fuel

DISCUSSION

The taxpayer was assessed use tax on purchases of forklift repair parts and fuel. The taxpayer claims these purchases are partially tax exempt because the forklifts were used one third of the time in moving work in process between various stages of production. The auditor found the forklifts were used exclusively in pre-production and post-production activities. Thus, the entire cost of repair parts and fuel was subject to use tax. Other than stating in its protest letter that the forklifts were used one third of the time in production-related activities, the taxpayer has not provided any evidence showing exactly how the forklifts were used in a tax exempt manner.

"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." Ind. Code § 6-8.1-5-1(b). The taxpayer's statement alone that the forklifts were used one third of the time in a tax exempt manner does not satisfy its burden of proof.

FINDING

The taxpayer's protest is denied.

IV. Use Tax – Liability for Use Tax on Purchases of Safety Gloves, Aprons, and Boots

DISCUSSION

The taxpayer was assessed use tax on its purchases of safety gloves, aprons, and boots. The taxpayer argues its purchases of safety gloves, aprons, and boots are tax exempt because they are necessary to protect its employees from extreme temperatures and potentially dangerous chemicals. "Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production" constitute essential and integral parts of the integrated production process and are tax exempt. Ind. Admin. Code tit. 45, r. 2.2-5-8(c)(2)(F).

The auditor determined that the safety gloves, aprons, and boots were used for the comfort of the employees and to keep their hands and clothes clean. The auditor found that most employees did not wear these items all the time and that whether these items were worn or not appeared to have no effect on the product or the employees' safety. The taxpayer has provided no evidence to support its claim that the items purchased were required to allow its employees to participate in the production process without sustaining injury or to prevent contamination of the product. The Department finds that the safety gloves, aprons, and boots were not required to allow the taxpayer's employees to participate in the production process without sustaining injury. Therefore, the taxpayer was properly assessed use tax for the purchase of these items.

FINDING

The taxpayer's protest is denied.

V. Use Tax – Liability for Use Tax on Purchases of Terry Cloth Gloves

DISCUSSION

The taxpayer was assessed use tax on its purchases of terry cloth gloves. The taxpayer argues that these gloves are used as a means of applying paint to the outer edges of decorative pine cones. The taxpayer states that the employees wear the terry cloth gloves, dip their hands into paint, and paint the outer edges of the pine cones by rolling the pine cones in their gloved hands.

Transactions involving tools and equipment to be directly used in the direct production, manufacture, finishing, etc. of other tangible personal property are tax exempt. Ind. Code § 6-2.5-5-3(b). Terry cloth gloves used in the manner described by the taxpayer are tax exempt. Any terry cloth gloves which are used merely for the comfort of the employees, however, are not exempt and would be assessed use tax just as the items described in Part IV of this Letter of Findings.

FINDING

The taxpayer's protest is sustained.

VI. Use Tax – Liability for Use Tax on Purchases of Boiler Compound and Water Softener Salt

DISCUSSION

The taxpayer was assessed use tax on purchases of boiler compound and water softener salt. The boiler compound is an additive put in the boiler water to help prevent scale build-up. A water softener is attached to the boiler and acts to help prevent scale build-up and reduces the amount of boiler compound needed. The water softener salt is used in the water softener and is necessary for the water softener to operate properly.

The taxpayer argues that the boiler is a piece of manufacturing equipment and, therefore, the boiler compound and the water softener salt are tax exempt purchases. In support of its position, the taxpayer cites an Indiana Administrative Code example which states that "[c]hemicals used to treat water used in the production of whiskey to ensure that the water is pure or to prevent scale buildup in the boilers and pipes" are "essential and integral parts of the integrated production process and are, therefore, exempt." Ind. Admin. Code tit. 45, r. 2.2-5-10(c)(2)(B).

The water treated by the chemicals in the cited example becomes part of the end product, the whiskey being produced. In the instant case, the water being treated with boiler compound and water softener salt does not become part of the end product. The boiler compound and the salt are only incidentally consumed by the taxpayer in its operation.

> 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 [or] processing....
>
> Ind. Code § 6-2.5-5-5.1(b).

The boiler compound and salt are not directly consumed in the direct production of personal property as required by the statute. Instead, those items serve a maintenance function by helping to keep the boiler and pipes free of scale. The taxpayer's products could be produced without the use of the boiler compound and the water softener salt. The production may be less efficient without use of those items, but production could continue. The boiler compound and water softener salt are not "essential and integral parts of an integrated process which produces tangible personal property." Ind. Admin. Code tit. 45, r. 2.2-5-12(c). Since those items serve a maintenance function, they are not tax exempt items. Ind. Admin. Code tit. 45, r. 2.2-5-12(f).

FINDING

The taxpayer's protest is denied.

VII. Use Tax – Liability for Use Tax on Purchases of UPC and Product Labels

DISCUSSION

The taxpayer was assessed use tax on purchases of various labels. The audit report described the labels as shipping labels. The taxpayer claims that the labels are actually UPC and product labels. According to the taxpayer, the labels are attached directly to the products it manufactures, making the labels part of the products and, therefore, exempt.

"Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business." Ind. Code § 6-2.5-5-6. The taxpayer attaches (incorporates) the product labels to other tangible personal property which the taxpayer manufactures. Therefore, to the extent they are used to identify the product for the consumer, the product labels become part of the taxpayer's product and are thus exempt purchases under Ind. Code § 6-2.5-5-6.

The UPC labels, however, may be used in a variety of ways. The taxpayer has failed to provide information regarding the utility of its UPC labels. Consequently, the Department must deny the taxpayer's protest of these proposed assessments.

FINDING

The taxpayer's protest is partially sustained and partially denied.

VIII. Use Tax – Liability for Use Tax on Purchases of Fan Motors and Fan Repair Parts

DISCUSSION

The taxpayer was assessed use tax on purchases of fan motors and fan repair parts. The taxpayer argues the fans are used to dry the product during the production process. Machinery, tools, and equipment directly used in the direct production of tangible personal property are tax exempt. Ind. Code § 6-2.5-5-3(b). Replacement parts for exempt machinery, tools, and equipment are also exempt. Ind. Admin. Code tit. 45, r. 2.2-5-8(h)(2).

The auditor reports that the fans are used exclusively to move air in the production facility for the comfort of the employees. This is not a function related to production and, thus, the fans are not exempt equipment. The taxpayer does not offer any evidence to support its claim that the fans are exempt as equipment directly used in the direct production of personal property. The purchases of the fan motors and fan repair parts, therefore, are not tax exempt purchases.

FINDING

The taxpayer's protest is denied.

IX. Use Tax – Liability for Use Tax on Purchases of Mothballs

The taxpayer was assessed use tax on its purchases of mothballs. The taxpayer argues that the mothballs are put inside the product packaging to protect it from insects and other vermin. The taxpayer concludes that the mothballs are part of packaging and, therefore, tax exempt. The taxpayer states that the courts have ruled that items used to prevent damage inside of containers are part of packaging and are exempt. The taxpayer does not, however, cite any cases to support this argument.

"The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added...." Ind. Admin. Code tit. 45, r. 2.2-5-16(a). The mothballs the taxpayer adds to the boxes to prevent infestation by insects may act to help preserve the product during shipping, but mothballs are not packaging. They do not act to enclose or contain the products the taxpayer is shipping. The taxpayer's purchases of mothballs are not tax exempt as containers or as wrapping material.

FINDING

The taxpayer's protest is denied.

X. Use Tax – Liability for Use Tax on Purchases of Miscellaneous Production Supplies and Equipment

The taxpayer was assessed use tax on purchases of storage drums, drum stands, drum handles, thermometers, buckets, scoops, PVC tank fittings, and staples. The taxpayer protests these assessments, arguing that all of these items are exempt under Ind. Admin. Code tit. 45, r. 2.2-5-10, as machinery, tools, and equipment directly used in the processing or refining of tangible personal property.

A. Storage drums, drum stands, and drum handles.

The taxpayer states that the drums are used to temporarily store chemicals used in the production process. The chemicals are raw materials. "Tangible personal property used in or for the purpose of storing raw material... is subject to tax...." Ind. Admin. Code tit. 45, r. 2.2-5-10(e). Thus, the storage drums and the associated equipment, the drum stands and handles, are subject to tax.

B. Thermometers.

The taxpayer states the thermometers it purchased "are used to test the temperature of various chemical processes during the production cycle." Taxpayer's Protest Letter, page 5 (received Oct. 29, 1997). The taxpayer maintains that the thermometers are items which are integral and essential to the production process making them exempt from use tax.

"Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." Ind. Code § 6-2.5-5-3(b). To qualify for the exemption, manufacturing machinery, tools, and equipment must have "an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property." Ind. Admin. Code tit. 45, r. 2.2-5-8(c).

The thermometers monitor the temperature of the chemicals used to process the taxpayer's products. They qualify as pieces of equipment that are essential and integral parts of an integrated process which produces tangible personal property and are, therefore, exempt from use tax.

C. Buckets and scoops.

The taxpayer states the buckets and scoops purchased are exempt from tax as equipment that is integral and essential to the production process. The buckets and scoops are used to scoop liquid raw materials from storage drums and introduce the materials into the production process.

> (c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.
>
> ...
>
> (g) 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.
>
> Ind. Admin. Code tit. 45, r. 2.2-5-10.

The buckets and scoops purchased by the taxpayer do not act upon or have an immediate effect on the property being processed. The buckets and scoops may be practical necessities for the taxpayer to be able to process its products, but they are not an integral part of an integrated process which produces tangible personal property. The buckets and scoops are not exempt equipment.

D. PVC tank fittings.

The taxpayer states its purchases of PVC tank fittings are exempt as repair parts for exempt equipment, that is, the boiler equipment. "Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax." Ind. Admin. Code tit. 45, r. 2.2-5-8(2).

To determine if the PVC tank fittings are exempt, it must first be determined whether the boiler itself is exempt. In the taxpayer's production operation, the boiler is used to heat water to make steam. The steam heat raises and maintains the temperature of the chemicals used in the bleaching process. The steam also heats a room to a temperature of between 100 and 150 degrees where the taxpayer's products are dried. The boiler is equipment acquired for the direct use in direct production of tangible personal property. Ind. Code § 6-2.5-5-3(b). The boiler is exempt equipment and the PVC tank fittings, as replacement parts for the boiler equipment, are also exempt.

E. Staples.

The taxpayer states the staples it purchased are exempt. The "staples are used to attach the header card to the plastic bag containing the product." Taxpayer's Protest Letter, page 5 (received Oct. 29, 1997). "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail sales tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." Ind. Code § 6-2.5-5-3(b). The staples are property acquired by the taxpayer for direct use in the manufacture of the taxpayer's products and, as such, are not subject to tax.

FINDING

The taxpayer's protest is denied on items A., and C. The taxpayer's protest is sustained on items B., D., and E.

XI. Use Tax – Calculation of Exempt Portion of Taxpayer's Purchase of Warehouse Cart

The taxpayer notes that the auditor had determined that 50% of the purchase price of warehouse carts were tax exempt. The taxpayer maintains the amount reported as subject to use tax for one of the cart purchases was miscalculated. The auditor is in agreement with the taxpayer on this issue. The amount subject to use tax should have been $54.00, not the $535.00 listed in the audit report. The taxpayer has met its burden of proving that the assessment was wrong. Ind. Code § 6-8.1-5-1(b).

FINDING

The taxpayer's protest is sustained.

XII. Use Tax – Liability for Use Tax on Purchases of Materials Used in Construction of Bleach Facility Buildings

DISCUSSION

In 1994, two buildings, which comprised the taxpayer's bleach facility, were destroyed by fire. The taxpayer rebuilt the two structures. The two buildings are the bleach unit and the greenhouse unit. The bleach unit is where the taxpayer bleached and rinsed its products. The products were then transferred to the greenhouse unit where they would be dried.

The taxpayer maintains that the materials purchased to rebuild the bleach facility units are tax exempt because the units are integral and essential to the processing of the taxpayer's products. The taxpayer cites an example from a Department of Revenue Sales Tax Bulletin in support of its argument. In the example, the materials used to construct a grain silo were exempt because the silo was integral and essential to the processing of the grain. Indiana Dept. of Revenue Sales Tax Bulletin #9(I)(B)(example 3)(April 1992).

> The general rule for the application of sales or use tax is that a purchase of tangible personal property to be used in Indiana is subject to tax unless a specific exemption is available.
>
> Indiana law provides several exemptions from sales and use tax relating to agricultural production. The exemptions are limited to purchases to be directly used in the direct production of food or commodities that are sold either for human consumption or for further food or commodity production.

Indiana Dept. of Revenue Sales Tax Bulletin #9(I)(April 1992).

Sales Tax Bulletin #9 does not apply to materials purchased by the taxpayer for construction of bleach facility buildings. "In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property." Ind. Admin. Code tit. 45, r. 2.2-4-21(a). The construction materials purchased by the taxpayer were properly assessed use tax by the auditor.

FINDING

The taxpayer's protest is denied.

XIII. Use Tax – Liability for Use Tax on Purchases of Photographs and Photographic Services

DISCUSSION

The taxpayer was assessed use tax on purchases of photographs and photographic services. The taxpayer hired a photography studio to take photos for the taxpayer's advertising catalog in 1994. The taxpayer has submitted eight invoices for the photographic services performed during 1994. The invoices show services and transfers of tangible personal property stated separately. The taxpayer argues that the entire amount charged by the photography studio should be tax exempt. The taxpayer, citing Indiana Department of Revenue Sales Tax Information Bulletin #46 (July 11, 1983), maintains that: 1.) the price for the tangible personal property the taxpayer received and the price of the services were separately stated on the invoices, 2.) the cost of the tangible personal property was inconsequential, 3.) the photography studio primarily sells services, 4.) the personal property was used or consumed as a necessary incident to the service, and 5.) the photography studio paid sales or use tax on the property at the time it acquired it.

> Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
>
> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
>
> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
>
> (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge, and;
>
> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Ind. Admin. Code tit. 45, r. 2.2-4-2(a).

Transactions meeting the four requirements of Ind. Admin. Code tit. 45, r. 2.2-4-2(a) do not constitute selling at retail and, thus, are not subject to the gross retail tax. The transactions between the taxpayer and the photography studio do not, however, meet the requirements of the regulation cited. "Photographers when taking, developing and printing photographs which are ultimately sold to a customer are considered to be selling at retail with respect to the charges made for such photographs." Indiana Department of Revenue Sales Tax Information Bulletin #34, I (April 4, 1983). The photography studio is a retail merchant selling at retail when selling photographs to the taxpayer. Thus, the first requirement of the regulation that the serviceman primarily be in an occupation which furnishes and sells services is not met. The object of the transaction in this case is the transfer of tangible personal property, not the provision of services.

The transfers of tangible personal property to the taxpayer are indicated on the invoices by the charges for prints. "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." Ind. Code § 6-2.5-3-2(a). All of the charges for prints are subject to use tax. The separately stated charges for services, such as labor and processing, as well as the charges for materials used, such as film, are exempt.

FINDING

The taxpayer's protest is partially sustained and partially denied.

XIV. Use Tax – Liability for Use Tax on Purchases of Computer Software

DISCUSSION

The taxpayer was assessed use tax on its purchases of computer software in 1994 and in 1996. Computer hardware was purchased along with the software and was stated separately on the invoices. Sales tax was paid on the computer hardware purchases. The taxpayer argues that both software purchases were for customized software and, according to Indiana Dept. of Revenue Sales Tax Information Bulletin #8, are tax exempt.

Sales Tax Information Bulletin #8 states in part:

> As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser. Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.
> Indiana Dept. of Revenue Sales Tax Information Bulletin #8(II)(B) (Feb. 9, 1990).

The auditor determined that the computer software purchased by the taxpayer was canned software and subject to tax. The copies of invoices provided by the taxpayer do not indicate that the software was customized and the taxpayer has submitted no other evidence in support of its claim. Use tax was properly assessed on the purchases of computer software.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980089.LOF

LETTER OF FINDINGS NUMBER: 98-0089
Sales and Use Tax
For Tax Periods: 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Difference in Taxable Sales

Authority: IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-6-7; IC 6-2.5-6-8

Taxpayer protests the assessment of gross income tax on receipts which Taxpayer claims constitute exempt agency receipts.

2. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

3. Sales and Use Tax: Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests.

4. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period January 1, 1997 – June 30, 1997. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Difference in Taxable Sales

DISCUSSION

Indiana imposes an excise tax, the gross retail tax, on retail transactions made by retail merchants. The merchant, as agent of the state, collects the tax from the purchaser. IC 6-2.5-2-1. The measure of the tax is the total gross retail income received in taxable transactions by the merchant. Tax applies at a rate of 5% of the gross retail income on each taxable transaction, rounded to the nearest whole cent. IC 6-2.5-2-2. The amount of a retail merchant's tax liability is determined pursuant to the following provisions of IC 6-2.5-6-7.

> Except as otherwise provided in IC 6-2.5-7 or in this chapter, a retail merchant shall pay to the department, for a particular reporting period, an amount equal to the product of:
> (1) five percent (5%); multiplied by
> (2) the retail merchant's total gross retail income from taxable transactions made during the reporting period.
> The amount determined under this section is the retail merchant's state gross retail and use tax liability regardless of the amount of tax he actually collects.

In the audit, the Department Auditor calculated the amount of sales tax due by multiplying Taxpayer's gross retail income as indicated in the sales journals by the tax rate of five percent (5%). Taxpayer testified that its computer registers computed the sales tax charged on each individual sale. The registers then calculated the total amount of sales tax collected on the individual transactions during the month. Taxpayer entered this number on the line on the ST 103 for tax to be paid to the state. Taxpayer then calculated the gross retail sales from this sales tax figure to enter onto the line for gross retail sales on the ST 103. Taxpayer argues, but was unable to substantiate, that the difference in sales tax as determined in the audit and as determined in Taxpayer's filings is attributed to the rounding to the nearest whole cent of tax on the sales tax chart issued by the Department. Taxpayer contends that its process reflects the proper amount of sales tax to be remitted to the state and that the Department process overstated the sales tax to be remitted.

IC 6-2.5-6-8 provides for an "income exclusion ratio" to adjust the sales tax liability. The enactment of this law indicates that the legislature was aware of the discrepancy between the two formulas for determining the sales tax liability.

The method of computation of the proper amount of tax to remit to Indiana is set out at IC 6-2.5-6-7 as previously cited. The Auditor correctly used this statutory procedure to compute Taxpayer's sales tax liability.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

> In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:
>
> (1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;
>
> (2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and
>
> (3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1(c) as "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's second point of protest is denied.

3. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer also protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

4. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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.

In this instance, Taxpayer failed to follow the instructions of the department in the way it reported its sales tax liability. This breach of its duty to properly report and remit sales taxes constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980102.LOF

LETTER OF FINDINGS NUMBER: 98-0102
Sales and Use Tax
For Tax Periods 1989-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with general information about the Department's official position concerning a specific issue.

ISSUE

I. Sales and Use Tax Assessment – Retail Merchant Doing Business in Indiana: Signs and Sign Installation

Authority: 45 IAC 2.2-3-19; 45 IAC 2.2-4-2(a)

Taxpayer, as an out-of-state manufacturer and installer of commercial signs, originally protested the imposition of sales and use tax on taxpayer's sales made to its Indiana customers.

STATEMENT OF FACTS

The taxpayer is a Pennsylvania based manufacturer and installer of commercial signs. Taxpayer also provides sign maintenance services. Taxpayer has no designated Indiana representatives and maintains no Indiana business location. Instead, on those occasions where taxpayer makes sales to Indiana customers, taxpayer subcontracts the installation work to local contractors. Alternatively, the taxpayer ships the completed sign into Indiana and the customer independently arranges for the required installation work. The taxpayer did not collect any Indiana sales tax during the period covered by the audit.

I. Sales and Use Tax Assessment – Retail Merchant Doing Business in Indiana: Signs and Sign Installation

The audit determined that the taxpayer's Indiana subcontractors, making installations of taxpayer's signs, were acting as taxpayer's representative agents. The audit also determined that taxpayer was liable for sales tax for those transactions made with Indiana customers. In making that determination, the audit cited 45 IAC 2.2-3-19 which states in part that,

> "[t]he use tax shall be paid by the purchaser to the retail merchant, who shall collect the tax as agent for the state of Indiana. (b) Retail merchants who must collect use tax as agent for the purchaser [include]: (2) Any retail merchant engaged in selling at retail for use, storage, or consumption in Indiana and having any representative, agent, saleman [sic], canvasser or solicitor operating in Indiana under the authority of the retail merchant or its subsidiary for the purpose of selling, delivering, or taking orders for the sale of any tangible personal property for use, storage, or consumption in Indiana."

The audit determined that taxpayer was a retail merchant, taxpayer's subcontractors were its Indiana agents, and that taxpayer's Indiana agents were engaged in delivering personal property for use and consumption in Indiana. As such, taxpayer was obligated to register as a retail merchant, collect use tax from its Indiana based customers, and forward the tax to the state of Indiana.

Similarly, the audit held that repair services performed by the taxpayer for its Indiana customers were subject to sales tax. Typically the provision of taxpayer's repair services also involved the transfer of associated tangible personal property. Although repair services alone are not normally subject to sales tax, 45 IAC 2.2-4-2(a) provides for the taxation of any such transaction when the price of the associated tangible personal property is not stated separately on the customer invoice. Because none of taxpayer's customer invoices differentiated between the repair service charges and the cost of the associated tangible personal property, the audit assessed sales tax on the entire amount of those invoices.

Following the completion of the audit and in order to assist the taxpayer in determining its tax liability, taxpayer was provided details of those customers for whom sales tax assessments were proposed. Taxpayer was advised of the procedure to follow regarding those customers who had accrued use tax and was given until December of 1997 to provide to the Department additional information as directed. The taxpayer was further advised that the fact that its customers had accrued use tax did not necessarily prove the tax had been paid. In those instances where the taxpayer was unable to provide adequate documentation that the sales and use tax had been paid, it was recommended that the tax stand as assessed.

Taxpayer originally submitted a written protest on April 1, 1998, but failed to specify upon what legal or substantive issue it based its protest. However, the taxpayer submitted additional information which the Appeals Analyst determined was sufficient to document the payment of a portion of the taxes at issue.

Whatever issues the taxpayer intended to raise in its original protest letter are moot because, during the hearing, taxpayer waived all substantive, legal, and procedural issues regarding the audit's assessment. Additionally, taxpayer waived its right to rely on any of the substantive legal, factual, or procedural issues raised by taxpayer's Indiana customers. Instead, taxpayer has requested that a re-determination, based upon the additional information supplied by taxpayer during the intervening two and one-half years, be made of taxpayer's remaining tax liability. Therefore, in the absence of any extant legal, substantive, or procedural issues, a supplemental audit is requested to determine the taxpayer's remaining liability.

FINDING

Taxpayer's protest is sustained subject to verification by audit.

DEPARTMENT OF STATE REVENUE

04980112.LOF

LETTER OF FINDINGS NUMBER: 98-0112 RST
Sales and Use Tax
For Years 1993 through 1995

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Use Tax – Imposition of Use Tax on Computer Software Updates

Authority: Ind. Code § 6-2.5-3-2; Indiana Department of Revenue Sales Tax Bulletin #2 (Aug. 1991); Indiana Department of Revenue Sales Tax Bulletin #8 (Feb. 9, 1990)

The taxpayer protests the imposition of use tax on purchases of computer software updates.

II. Tax Administration – Penalty

Authority: Ind. Code § 6-8.1-10-2.1; Ind. Admin. Code tit. 45, r. 15-11-2

The taxpayer protests the imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer, a banking entity, is a Delaware corporation conducting various types of mortgage services in Indiana. A sales and use tax audit was completed on September 22, 1997. The taxpayer was assessed use tax on several items including purchases of computer software updates from three different vendors. The taxpayer filed a timely protest and on June 20, 2000, the taxpayer waived its right to an administrative hearing.

I. Use Tax – Imposition of Use Tax on Purchases of Computer Software Updates

DISCUSSION

The taxpayer protests the imposition of use tax on purchases of computer software, which the taxpayer characterizes as updates. The purchases were made from three different companies during the audit period. The taxpayer had signed maintenance contracts with the companies supplying the updates. The taxpayer maintains that updates for computer software are not taxable. The taxpayer does not cite any legal sources in support of its position but does submit copies of invoices and contracts for the purchases made.

"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." Ind. Code § 6-2.5-3-2(a). The taxpayer used tangible personal property in Indiana that was acquired in a retail transaction.

The purchase of pre-written, or canned, computer software is subject to tax.

> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer.

Indiana Department of Revenue Sales Tax Information Bulletin #8 (Feb. 9, 1990).

The copies of invoices and contracts submitted by the taxpayer indicate that the computer software contracted for was pre-written, not custom software designed specifically for the taxpayer. Purchases of updates for pre-written computer software are also taxable. An example from Sales Tax Information Bulletin #2 is illustrative. The example concerns the customer of a computer software company purchasing a maintenance agreement from the software company.

> [T]he maintenance agreement also entitles the customer to four program updates per year. The program updates are available to all of the company's customers who purchased the software package. The maintenance is subject to sales tax because it is a certainty that tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement.

Indiana Department of Revenue Sales Tax Information Bulletin #2, example 5 (Aug. 1991).

This example clearly shows that computer software updates are taxable as tangible personal property. The invoices submitted by the taxpayer indicate that sales tax was not paid on all of the pre-written software purchases made during the audit period, therefore use tax was properly assessed.

FINDING

The taxpayer's protest is denied.

II. Tax Administration – Penalty

DISCUSSION

The taxpayer protests the imposition of a 10% negligence penalty. The taxpayer states that the penalty was based on the use tax assessed in the audit and the use tax liability resulted from vendors failing to charge sales tax to the taxpayer. The taxpayer also states that it has implemented changes in its procedures to ensure adherence to Indiana tax law in the future.

"If a person incurs, upon examination by the department, a deficiency that is due to negligence, the person is subject to a penalty." Ind. Code § 6-8.1-10-2.1(a)(3). The penalty is ten percent (10%) of "the amount of the deficiency as finally determined by the department." Ind. Code § 6-8.1-10-2.1(b)(4). Negligence is defined in the Administrative Code 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." Ind. Admin. Code tit. 45, r. 15-11-2(b).

Provision is made for the waiver of the ten percent (10%) penalty:

> 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.

Ind. Admin. Code tit. 45, r. 15-11-2(c).

The taxpayer made many purchases during the audit period where sales tax was not charged and the taxpayer failed to self-assess use tax. This amounts to negligence on the part of the taxpayer and the 10% penalty was properly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980119.LOF

LETTER OF FINDINGS NUMBER 98-0119 ST
Sales and Use Tax
For Tax Periods: 1994 through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax – Double Assessment

Authority: IC 6-2.5-2-1; IC 6-8.1-5-1; IC 6-8.1-5-4; IC 6-2.5-4-12

Taxpayer protests proposed assessments of use tax. Taxpayer contends one of the assessments was redundant.

II. Sales/Use Tax – Purchases at Auction

Authority: IC 6-2.5-2-1; IC 6-2.5-5-3; IC 6-8.1-5-1; IC 6-8.1-5-4

Taxpayer protests proposed assessments of use tax on its auction purchases.

III. Sales/Use Tax – Tires

Authority: IC 6-2.5-2-1; IC 6-2.5-5-3; IC 6-8.1-5-1; IC 6-8.1-5-4

Taxpayer protests proposed assessments of use tax on its purchase of tires.

IV. Sales/Use Tax – Casual Sales

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2

Taxpayer protests the proposed assessment of use tax on its purchase of machinery from an individual seller.

V. Sales/Use Tax – 3000 Trogen Endloader and Loader Bucket

Authority: IC 6-2.5-2-1; IC 6-2.5-5-3; IC 6-8.1-5-1; IC 6-8.1-5-4

Taxpayer protests proposed assessments of use tax on equipment that, according to taxpayer, was used exclusively for exempt purposes.

VI. Sales/Use Tax – Parts and Labor: Installation of Truck Parts

Authority: IC 6-2.5-1-1; IC 6-2.5-2-1; IC 6-2.5-4-1; IC 6-8.1-5-1; IC 6-8.1-5-4

Taxpayer protests proposed assessments of use tax on its purchase of services.

VII. Sales/Use Tax – Komatsu 300 Excavator

Authority: IC 6-2.5-5-3; IC 6-8.1-5-1; IC 6-8.1-5-4

Taxpayer protests proposed assessments of use tax on an excavator.

VIII. Tax Administration – Negligence Penalty

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

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is engaged in the construction, excavation, and demolition business. Activities provided by taxpayer include earth-moving, building demolition, flood control projects, city sewer systems, waste water treatment facilities, and levee and dam construction. Additionally, taxpayer operates a gravel pit where sand, stone, gravel, and septic rock is processed and sold.

During the audit period (1994-1996), taxpayer failed to pay sales tax on its acquisition of tires, tools, supplies, machinery, and equipment. Consequently, Audit proposed additional assessments of use tax. Taxpayer protests these proposed assessments.

I. Sales/Use Tax – Double Assessment

DISCUSSION

Retail transactions made in Indiana are subject to sales tax; the person who acquires property in a retail transaction subject to sales tax shall pay the tax to the retail merchant as an amount additional to the consideration in the transaction. IC 6-2.5-2-1. Conversely, use tax "is imposed on the storage, use, or consumption of tangible personal property in Indiana when the sales tax has not been paid. IC 6-2.5-3-2 and IC 6-2.5-3-4.

Taxpayer has been assessed use tax on two (2) purchases—one listed as "tools," the other as a "sign." Both valued at $925.00. Both purchased September 14, 1994. As sales tax was not paid on these purchases, Audit proposed use tax assessments on $1,850.00. Taxpayer insists only one (1) purchase of $925.00 was made on September 14, 1994.

During audit, an invoice for $925.00 was noted. This invoice represented taxpayer's purchase, at auction, of a concrete saw ($100.00), a pump (375.00), and a "Federal Arrow Board" ($450.00). The invoice was dated September 14, 1994. Audit also noted a $925.00 entry in taxpayer's "Depreciation Schedule" for a "Sign." This entry was also dated September 14, 1994.

The evidence and circumstances strongly suggest taxpayer made only one $925.00 purchase on September 14, 1994. On that day, taxpayer purchased three items—a saw, a pump, and one federal arrow board—from one vendor. The federal arrow board, however, was actually a sign. Later, the three items were entered as one on taxpayer's "Depreciation Schedule." The label given to this consolidated entry was "sign."

FINDING

Taxpayer's protest is sustained.

II. Sales/Use Tax – Purchases at Auction

DISCUSSION

Taxpayer argues items purchased at auction—i.e., the saw, pump, and "sign"—are exempt from sales tax because the items were purchased at auction.

IC 6-2.5-4-12 addresses the taxation of sales made at auction. The language reads:

(a) A person is a retail merchant making a retail transaction when he sells tangible personal property at auction.

(b) Notwithstanding subsection (a), a person is not a retail merchant making a retail transaction when:

(1) he makes isolated or occasional sales of tangible personal property at auction;

(2) the sales occur on the premises of the owner of the tangible personal property; and

(3) the owner of the tangible personal property did not originally acquire that property for resale.

Taxpayer's purchases do not qualify for the exemption provided by IC 6-2.5-4-12. The items taxed were purchased by taxpayer from a commercial auction house. Such vendors acquire tangible personal property (via purchase or consignment) for purposes of resale. Consequently, the requirements of subsection (b)(3) have not been met.

FINDING

Taxpayer's protest is denied.

III. Sales/Use Tax – Tires Purchased

DISCUSSION

Taxpayer protests proposed assessments of use tax on tires purchased for exempt machinery. Specifically, these tires were purchased for a loader and mechanized end-dump that taxpayer contends were used at its exempt gravel pit production site.

IC 6-2.5-5-3(b) provides for the following exemptions:

"Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property."

Taxpayer is engaged in a variety of activities—some exempt, some not. Construction and excavation represent nonexempt service activities. Taxpayer's gravel pit operation, however, falls within the scope of "mining" or "processing"—both exempt activities. Audit assessed use tax on taxpayer's acquisition of these tires because at the time of the audit taxpayer failed to document its assertion that the tires were mounted on equipment used exclusively in exempt operations. At hearing, taxpayer demonstrated the tires are mounted on exempt machinery.

FINDING

Taxpayer's protest is sustained.

IV. Sales/Use Tax – Casual Sales

DISCUSSION

Taxpayer purchased equipment (Cat Roller 825B) for use in nonexempt business activities. Taxpayer failed to pay sales tax on this acquisition. Audit, therefore, proposed additional assessments of use tax.

Retail transactions made in Indiana are subject to sales tax. The person who acquires property in a retail transaction "shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction." IC 6-2.5-2-1(b).

Taxpayer protests this particular assessment of use tax because the machinery was not purchased in a retail transaction. Rather, the machinery was purchased in a "casual sale" from a third-party individual. Taxpayer relies on the language of 45 IAC 2.2-1-1(d), which provides:

Casual Sales. The Indiana gross retail [sales] tax is not imposed on gross receipts from casual sales of motor vehicles and sales of rental property. A casual sale is an isolated or occasional sale by the owner of tangible personal property purchased or otherwise acquired for his use or consumption, where he is not regularly engaged in the business of making such sales.

Also see *Information Bulletin #20, Sales Tax*, (April 18, 1983).

Taxpayer purchased the equipment from a retail vendor ("Vendor"). The cancelled check and "picking" slip indicate the equipment was ordered and billed from Vendor. Taxpayer insists that although the Vendor delivered the machinery to, and collected the purchase price from, taxpayer, those actions were taken on behalf of the actual seller—a third-party individual. The third-party individual has submitted a signed letter to that effect.

Notwithstanding any "agreement" between Vendor and the third-party individual, taxpayer purchased its equipment (as evidenced by the submitted documentation) from an Indiana registered retail merchant (i.e., the "Vendor"). Taxpayer did not issue exemption certificates or direct pay permits. The Vendor, therefore, was required to collect sales tax on the transaction. IC 6-2.5-2-1. Sales tax, however, was not collected. Consequently, taxpayer now owes use tax on its acquisition of the Cat Roller 825B. IC 6-2.5-3-2.

FINDING

Taxpayer's protest is denied.

V. Sales/Use Tax – 3000 Trogen Endloader and Loader Bucket

DISCUSSION

Taxpayer protests proposed assessments of use tax on 20% of the cost of equipment (the 3000 Trogen Endloader and Loader Bucket) which, according to taxpayer, is used at its gravel pit in the direct production of sand and gravel.

Retail transactions made in Indiana are subject to sales tax. The person who acquires property in a retail transaction subject to sales tax shall pay the tax to the retail merchant. IC 6-2.5-2-1. Absent exemptions, if sales tax is not paid, use tax is owed. IC 6-2.5-3-2. In this instance, taxpayer failed to pay sales tax on these purchases.

An exemption from sales and use taxes is provided, pursuant to IC 6-2.5-5-3, for tangible personal property purchased and then used in certain production and manufacturing activities. Specifically, IC 6-2.5-5-3(b) states:

> "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property."

The burden of proving that an assessment made by the Department is erroneous rests with the person against whom the proposed assessment is made. IC 6-8.1-5-1(b). To this end, every person subject to such taxation must keep books and records so the Department may determine said person's tax liability based upon such documentation. Such records include all source documents necessary in determination of tax liability, including invoices, register tapes, receipts, and cancelled checks. IC 6-8.1-5-4.

Given the utility of taxpayer's equipment (i.e., the 3000 Trogen Endloader and Loader Bucket) and the nature of taxpayer's business activities (excavation and gravel production), taxpayer is entitled to a pro-rata exemption to the extent the equipment is used in taxpayer's gravel pit operations. IC 6-2.5-5-3(b). Audit assessed only 20% of the equipment's purchase cost, which is a reasonable pro-rata exemption absent more precise records from the taxpayer.

FINDING

Taxpayer's protest is denied.

VI. Sales/Use Tax – Parts and Labor: Installation of Truck Parts

DISCUSSION

Taxpayer was assessed use tax on the purchase and installation of truck parts (invoice # 9258). Taxpayer concedes sales tax should have been paid on the parts. But taxpayer also contends sales tax should not have been paid—and, in fact, was not paid—on installation charges. As taxpayer failed to pay sales tax or remit use tax on any portion of the purchase price, Audit proposed additional assessments of use tax on the entire invoice amount—i.e., $23,600.00. This amount represented the *purchase* and *installation* of two (2) truck axles.

In response to the Department's request for additional information, taxpayer submitted a signed statement from its vendor substantiating taxpayer's assertion that the actual value of tangible personal property purchased was $18,760.00—with installation charges of $4,840.00 representing the balance.

Given this additional information, the Department finds that taxpayer should have remitted use tax on $18,760.00 for the parts purchased—but not on the remaining invoice amount of $4,840.00.

FINDING

Taxpayer's protest is sustained.

VII. Sales/Use Tax – Komatsu 300 Excavator

DISCUSSION

Taxpayer protests a portion of the proposed assessment of use tax on its purchase of a Komatsu 300 Excavator ("excavator"). This excavator, according to taxpayer, was predominantly used (with two exceptions) in exempt gravel pit operations. Therefore, taxpayer reasons, to the extent the excavator was used in the direct production of sand and gravel, the excavator should qualify for an exemption. But according to Audit, taxpayer was unable to document the excavator's exempt and non-exempt utility. Consequently, Audit proposed assessments on the total purchase price of the excavator.

In response to the Department's request for additional information, taxpayer submitted the following explanation:

> [The Komatsu 300] is a very big machine that is extremely heavy and overwidth [sic]. It was purchased to be used at the sand and gravel company to remove dirt (overburden) from on top of the sand and gravel. To move the machine requires special equipment and a special overwidth and overweight permit from the State Highway Department.
>
> The construction company has two excavators of their own, but did get in a bind and had to use the 300 Komatsu in a couple of jobs. We have gone through our records and have found two jobs that this machine was used on.... It [the Komatsu 300] was used a total of 432 hours. This was the extent of use outside of the gravel pit.

Taxpayer purchased the Komatsu 300 excavator on May 9, 1995. The audit period extended through December 31, 1996. Taxpayer owned the excavator for approximately nineteen (19) months (82 weeks) of the audit period. Taxpayer has stated the excavator was used two (2) times for a total of 432 hours. Assuming a fifty (50) hour work week, the excavator was used 8.64 weeks. From these figures, the Department finds that taxpayer used its Komatsu 300 excavator in non-exempt construction activities 10.53% of the time *(8.64 wks / 82 wks = 10.53%)*, and used the excavator in exempt activities (its gravel pit operations) 89.47% of the time.

FINDING

Taxpayer's protest is sustained. The Komatsu 300 excavator qualifies for a pro-rata exemption of 89.47%.

VIII. Tax Administration – Negligence Penalty

DISCUSSION

Taxpayer protests the Department's imposition of a ten percent (10%) penalty. A negligence penalty may be imposed under IC 6-8.1-10-2.1 and 45 IAC 15-11-2.

45 IAC 15-11-2 provides:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 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.

During the audit period, taxpayer failed to pay sales tax or remit use tax on a number of taxable purchases made from Indiana vendors. Many items assessed in this audit were issues addressed in previous audits. Additionally, most of the contested issues resulted from taxpayer's failure to keep sufficient records. Taxpayer's omissions were neither justifiable nor reasonable.

FINDING

Taxpayer's protest is denied. The negligence penalty is appropriate.

DEPARTMENT OF STATE REVENUE

04980248.LOF

LETTER OF FINDINGS NUMBER: 98-0248
Sales and Use Tax
For Tax Periods: 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Difference in Taxable Sales

Authority: IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-6-7; IC 6-2.5-6-8

Taxpayer protests the assessment of gross income tax on receipts which Taxpayer claims constitute exempt agency receipts.

2. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

3. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests.

4. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the years 1994-1996. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Difference in Taxable Sales

DISCUSSION

Indiana imposes an excise tax, the gross retail tax, on retail transactions made by retail merchants. The merchant, as agent of the state, collects the tax from the purchaser. IC 6-2.5-2-1. The measure of the tax is the total gross retail income received in taxable transactions by the merchant. Tax applies at a rate of 5% of the gross retail income on each taxable transaction, rounded to the nearest whole cent. IC 6-2.5-2-2. The amount of a retail merchant's tax liability is determined pursuant to the following provisions of IC 6-2.5-6-7.

Except as otherwise provided in IC 6-2.5-7 or in this chapter, a retail merchant shall pay to the department, for a particular reporting period, an amount equal to the product of:

(1) five percent (5%); multiplied by

(2) the retail merchant's total gross retail income from taxable transactions made during the reporting period.

The amount determined under this section is the retail merchant's state gross retail and use tax liability regardless of the amount of tax he actually collects.

In the audit, the Department Auditor calculated the amount of sales tax due by multiplying Taxpayer's gross retail income as indicated in the sales journals by the tax rate of five percent (5%). Taxpayer testified that its computer registers computed the sales tax charged on each individual sale. The registers then calculated the total amount of sales tax collected on the individual transactions during the month. Taxpayer entered this number on the line on the ST 103 for tax to be paid to the state. Taxpayer then calculated the gross retail sales from this sales tax figure to enter onto the line for gross retail sales on the ST 103. Taxpayer argues, but was unable to substantiate, that the difference in sales tax as determined in the audit and as determined in Taxpayer's filings is attributed to the rounding to the nearest whole cent of tax on the sales tax chart issued by the Department. Taxpayer contends that its process reflects the proper amount of sales tax to be remitted to the state and that the Department process overstated the sales tax to be remitted.

IC 6-2.5-6-8 provides for an "income exclusion ratio" to adjust the sales tax liability. The enactment of this law indicates that the legislature was aware of the discrepancy between the two formulas for determining the sales tax liability.

The method of computation of the proper amount of tax to remit to Indiana is set out at IC 6-2.5-6-7 as previously cited. The Auditor correctly used this statutory procedure to compute Taxpayer's sales tax liability.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1(c) as a debt which is "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's second point of protest is denied.

3. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer also protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

4. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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.

In this instance, Taxpayer failed to follow the instructions of the department in the way it reported its sales tax liability. This breach of its duty to properly report and remit sales taxes constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980249.LOF

LETTER OF FINDINGS NUMBER: 98-0249
Sales and Use Tax
For Tax Periods: 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Difference in Taxable Sales

Authority: IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-6-7; IC 6-2.5-6-8

Taxpayer protests the assessment of gross income tax on receipts which Taxpayer claims constitute exempt agency receipts.

2. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

3. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests.

4. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period January 1, 1997 – June 30, 1997. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Difference in Taxable Sales

DISCUSSION

Indiana imposes an excise tax, the gross retail tax, on retail transactions made by retail merchants. The merchant, as agent of the state, collects the tax from the purchaser. IC 6-2.5-2-1. The measure of the tax is the total gross retail income received in taxable transactions by the merchant. Tax applies at a rate of 5% of the gross retail income on each taxable transaction, rounded to the nearest whole cent. IC 6-2.5-2-2. The amount of a retail merchant's tax liability is determined pursuant to the following provisions of IC 6-2.5-6-7.

Except as otherwise provided in IC 6-2.5-7 or in this chapter, a retail merchant shall pay to the department, for a particular reporting period, an amount equal to the product of:

(1) five percent (5%); multiplied by

(2) the retail merchant's total gross retail income from taxable transactions made during the reporting period.

The amount determined under this section is the retail merchant's state gross retail and use tax liability regardless of the amount of tax he actually collects.

In the audit, the Department Auditor calculated the amount of sales tax due by multiplying Taxpayer's gross retail income as indicated in the sales journals by the tax rate of five percent (5%). Taxpayer testified that its computer registers computed the sales tax charged on each individual sale. The registers then calculated the total amount of sales tax collected on the individual transactions during the month. Taxpayer entered this number on the line on the ST 103 for tax to be paid to the state. Taxpayer then calculated the gross retail sales from this sales tax figure to enter onto the line for gross retail sales on the ST 103. Taxpayer argues, but was unable to substantiate, that the difference in sales tax as determined in the audit and as determined in Taxpayer's filings is attributed to the rounding to the nearest whole cent of tax on the sales tax chart issued by the Department. Taxpayer contends that its process reflects the proper amount of sales tax to be remitted to the state and that the Department process overstated the sales tax to be remitted.

IC 6-2.5-6-8 provides for an "income exclusion ratio" to adjust the sales tax liability. The enactment of this law indicates that the legislature was aware of the discrepancy between the two formulas for determining the sales tax liability.

The method of computation of the proper amount of tax to remit to Indiana is set out at IC 6-2.5-6-7 as previously cited. The Auditor correctly used this statutory procedure to compute Taxpayer's sales tax liability.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1 (c) as "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's second point of protest is denied.

3. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer also protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

4. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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.

In this instance, Taxpayer failed to follow the instructions of the department in the way it reported its sales tax liability. This breach of its duty to properly report and remit sales taxes constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980250.LOF

LETTER OF FINDINGS NUMBER: 98-0250
Sales and Use Tax
For Tax Periods: 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Difference in Taxable Sales

Authority: IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-6-7; IC 6-2.5-6-8

Taxpayer protests the assessment of gross income tax on receipts which Taxpayer claims constitute exempt agency receipts.

2. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

3. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests.

4. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period 1994-1996. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Difference in Taxable Sales

DISCUSSION

Indiana imposes an excise tax, the gross retail tax, on retail transactions made by retail merchants. The merchant, as agent of the state, collects the tax from the purchaser. IC 6-2.5-2-1. The measure of the tax is the total gross retail income received in taxable transactions by the merchant. Tax applies at a rate of 5% of the gross retail income on each taxable transaction, rounded to the nearest whole cent. IC 6-2.5-2-2. The amount of a retail merchant's tax liability is determined pursuant to the following provisions of IC 6-2.5-6-7.

Except as otherwise provided in IC 6-2.5-7 or in this chapter, a retail merchant shall pay to the department, for a particular reporting period, an amount equal to the product of:

(1) five percent (5%); multiplied by

(2) the retail merchant's total gross retail income from taxable transactions made during the reporting period.

The amount determined under this section is the retail merchant's state gross retail and use tax liability regardless of the amount of tax he actually collects.

In the audit, the Department Auditor calculated the amount of sales tax due by multiplying Taxpayer's gross retail income as indicated in the sales journals by the tax rate of five percent (5%). Taxpayer testified that its computer registers computed the sales tax charged on each individual sale. The registers then calculated the total amount of sales tax collected on the individual transactions during the month. Taxpayer entered this number on the line on the ST 103 for tax to be paid to the state. Taxpayer then calculated the gross retail sales from this sales tax figure to enter onto the line for gross retail sales on the ST 103. Taxpayer argues, but was unable to substantiate, that the difference in sales tax as determined in the audit and as determined in Taxpayer's filings is attributed to the rounding to the nearest whole cent of tax on the sales tax chart issued by the Department. Taxpayer contends that its process reflects the proper amount of sales tax to be remitted to the state and that the Department process overstated the sales tax to be remitted.

IC 6-2.5-6-8 provides for an "income exclusion ratio" to adjust the sales tax liability. The enactment of this law indicates that the legislature was aware of the discrepancy between the two formulas for determining the sales tax liability.

The method of computation of the proper amount of tax to remit to Indiana is set out at IC 6-2.5-6-7 as previously cited. The Auditor correctly used this statutory procedure to compute Taxpayer's sales tax liability.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1 (c) as a debt which is "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's second point of protest is denied.

3. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer also protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

4. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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.

In this instance, Taxpayer failed to follow the instructions of the department in the way it reported its sales tax liability. This breach of its duty to properly report and remit sales taxes constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980252.LOF

LETTER OF FINDINGS NUMBER: 98-0252
Sales and Use Tax
For Tax Periods: 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

2. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests the adjustments made concerning marketing expenses.

3. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period 1994-1996. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1 (c) as a debt which is "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer also protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

3. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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.

Taxpayer had a duty to maintain adequate records to substantiate its computation of the sales and use tax due to the state of Indiana and provide those records at the Auditor's request. Taxpayer also failed to remit use tax on capital assets which was an issue in a previous audit. These breaches of Taxpayer's duty constitute negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980253.LOF

LETTER OF FINDINGS NUMBER: 98-0253
Sales and Use Tax
For Tax Periods: 1995-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests the imposition of tax on certain marketing expenses.

2. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period June 1, 1995- December 31, 1996. Taxpayer protested part of the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

2. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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.

In addition to the protested items, Taxpayer failed to timely remit all sales tax collected. Taxpayer also failed to pay sales tax or accrue use tax on other taxable purchases.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980254.LOF

LETTER OF FINDINGS NUMBER: 98-0254
Sales and Use Tax
For Tax Periods: January 1, 1997 – June 30, 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

2. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 2.2-3-16.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period January 1, 1997-June 30, 1997. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax: Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1 (c) as a debt which is "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's protest is denied.

2. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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.

Taxpayer had a duty to maintain adequate records to substantiate its computation of the sales and use tax due to the state of Indiana and provide those records at the Auditor's request. Taxpayer's breach of this duty constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980255.LOF

LETTER OF FINDINGS NUMBER: 98-0255
Sales and Use Tax
For Tax Periods: 1994-1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests the assessment of tax on certain marketing expenses.

2. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of a penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period 1994-1995. Taxpayer protested a portion of the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

2. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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.

Taxpayer had a duty to maintain adequate records to substantiate its computation of the sales and use tax due to the state of Indiana and provide those records at the Auditor's request. Taxpayer also failed to pay sales tax or accrue use tax on categories of purchases that were also taxed in a previous audit.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980256.LOF

LETTER OF FINDINGS NUMBER: 98-0256
Sales and Use Tax
For Tax Periods: 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Marketing Expenses

Authority: 45 IAC 2.2-3-16

Taxpayer protests the imposition of tax on certain marketing expenses.

2. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period January 1, 1997-June 30, 1997. Taxpayer protested a portion of the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Marketing Expenses

DISCUSSION

Taxpayer protests the assessment of use tax on certain expense accounts. These accounts included promotional materials such as banners and statement stuffers that were centrally purchased and stored in Ohio before being distributed to the Indiana stores. Taxpayer contends that it paid use taxes on these accounts pursuant to an audit by Ohio. Taxpayer offered a copy of a check and letter as evidence it had paid the taxes to Ohio. Indiana allows a credit for use taxes paid to another state. 45 IAC 2.2-3-16.

FINDING

Taxpayer's protest is sustained subject to audit verification.

2. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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.

In addition to the protested items, Taxpayer failed to timely remit all sales tax collected. Taxpayer also failed to pay sales tax or accrue use tax on other taxable purchases.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980257.LOF

LETTER OF FINDINGS NUMBER: 98-0257
Sales and Use Tax
For Tax Periods: 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Bad Debt Deductions

Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166; 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

2. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the tax period 1994-1996. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1 (c) as a debt which is "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's protest is denied.

2. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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.

Taxpayer had a duty to maintain adequate records to substantiate its computation of the sales and use tax due to the state of Indiana and provide those records at the Auditor's request. Taxpayer's breach of this duty constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980606.LOF

LETTER OF FINDINGS NUMBER: 98-0606 RST
Sales and Use Tax
For Years 1994-1997

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax – Imposition

Authority: Ind. Code § 6-8.1-5-1(b); Indiana Department of Revenue, Form AD-9, Explanation of Adjustments (Aug. 7, 1998)

The taxpayer protests the amount of sales tax assessed in the audit report.

II. Use Tax – Sample Projection Methodology

Authority: Ind. Code § 6-2.5-5-3; Ind. Admin. Code tit. 45, r. 2.2-5-8; Ind. Admin. Code tit. 45, r. 2.2-5-12; Indiana Dept. of Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dept. of State Revenue v. RCA Corporation, 310 N.E.2d 96 (Ind. App. 1974)

The taxpayer protests the sample projection methodology used in the audit report.

III. Use Tax – Imposition

Authority: Ind. Code § 6-2.5-2-1; Ind. Code § 6-2.5-3-2; Ind. Code § 6-2.5-5-3; Ind. Admin. Code tit. 45, r. 2.2-3-12; Ind. Admin. Code tit. 45, r. 2.2-5-8; Indiana Dept. of Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983)

The taxpayer protests the imposition of use tax on various specific purchases.

IV. Tax Administration – Penalty

Authority: Ind. Code § 6-8.1-10-2.1; Ind. Admin. Code tit. 45, r. 15-11-2

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer, incorporated in the state of Delaware, is a manufacturer of concrete pipes and pre-stressed concrete products. The taxpayer operates several production facilities in Indiana. The manufacturing process consists of raw materials (aggregate) being loaded onto a conveying system that moves the material to a batch plant where it is mixed to make cement. The cement is poured into molds to form concrete pipes. A packer-head machine vibrates the product to ensure consistency. An off-bearing process is performed by forklifts to move the product from the packer-head machine into the kiln for curing. A steam generator in the kiln area is used to heat and cure the product. A tip-out process is performed where forklifts remove the product from the molds. Forklifts move the product to the yard where the finishing process is performed, imperfections in the product are corrected, and the ends of the pipe are painted for identification purposes.

On August 7, 1998, a sales and use tax audit was completed for the years 1994-1997. Sales tax was assessed for the audit period as a result of a difference between Indiana sales tax remittances and the records of Indiana taxable sales. Use tax was assessed after a sample review of actual purchase invoices for the period April 1, 1997 to December 31, 1997 and a projection of purchases for the entire audit period based on that sample. The taxpayer signed an Agreement for Projecting Audit Results while reserving a right to protest amounts identified in the audit as taxable purchases.

I. Sales Tax – Imposition

DISCUSSION

The taxpayer was assessed sales tax for the audit period. In his report, the auditor explained the reason for the sales tax assessment:

> A review of sales invoices, records and tax account reconciliations revealed various differences between Indiana sales tax remittances and the records of Indiana taxable sales. The records indicated various amounts credited for collection of sales tax where reporting and remittances to the state were not in evidence or variances could not be accounted for.
>
> Indiana Department of Revenue, Form AD-9, Explanation of Adjustments, p. 6 (Aug. 7, 1998).

In its protest letter, the taxpayer requested additional time to submit evidence supporting its dispute of sales tax assessed in the audit report. By the hearing date, March 7, 2000, no supporting evidence on the sales tax issue had been submitted and during the hearing, the taxpayer indicated that no such evidence would be submitted. "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." Ind. Code § 6-8.1-5-1(b). The taxpayer has submitted no evidence to indicate that the assessment was wrong. The taxpayer has not met its statutory burden of proof, therefore the taxpayer's protest of this issue must be denied.

FINDING

The taxpayer's protest is denied.

II. Use Tax – Sample Projection Methodology

DISCUSSION

The taxpayer protests the methodology of the sample projection used by the auditor to arrive at use tax owed for the audit period. The taxpayer signed a Form AD-10A, Agreement for Projecting Audit Results. The execution and acceptance of the agreement does not deprive the taxpayer of any rights to appeal. The sample of purchase invoices reviewed by the auditor covered a nine month period in 1997, as noted in the Statement of Facts, and was used to project purchases subject to use tax for the entire audit period. In its protest letter, the taxpayer argues that "[i]n any projection technique, principles dictate the sample be an exact representation of the population from which the sample was derived." Taxpayer's Protest Letter, page 2 (Oct. 8, 1998). For the sample to be an *exact* representation of the population from which it is derived, it would have to be a review of *all* of the records for the audit period. What the taxpayer suggests would no longer be a sample.

The taxpayer protests the inclusion of six specific items in the use tax sample. These items will be addressed individually.

A. Invoices for Repair Work Performed on Heaters (Plant #5160)

According to the taxpayer, the heaters are used to maintain a certain ambient temperature so that the raw materials may be used in the manufacturing process. The taxpayer states that if the temperature is too low, the raw materials cannot be used. The invoices in question were for repairs done to the heaters. In support of its argument, the taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-5-8(h)(2) which allows a tax exemption for "replacement parts used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment.... "

The question is whether or not the heaters qualify as exempt equipment. For the heaters to be exempt equipment, they must have been acquired "for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." Ind. Code § 6-2.5-5-3(b). The taxpayer states that the heaters are used to control the ambient, that is, surrounding, temperature. This is analogous to the RCA case where RCA claimed an exemption for air conditioning equipment, arguing that the equipment was an essential and integral part of the process of manufacturing television picture tubes. Indiana Dept. of State Revenue v. RCA Corporation, 310 N.E.2d 96, 98 (Ind. App. 1974). In finding that the air conditioning equipment did not meet the "direct use in the direct production, manufacture, " etc. standard set out in Ind. Code § 6-2.5-5-3, the court stated:

> Whatever effect (whether positive or negative) that RCA's air conditioning or environmental control equipment may have on the tubes RCA manufactures, or on the process of their manufacture, is exerted through the medium or agency of the environment (i.e. the air). The very name of the equipment, whether "air conditioning" or "environmental control", signifies that its immediate effect is on the surroundings in which the manufacturing process takes place and only remotely, through the intervening agency of those surroundings, on the tubes or on the process by which they are manufactured.
>
> Indiana Dept. of State Revenue v. RCA Corporation, 310 N.E.2d 96, 100 (Ind. App. 1974).

As with the air conditioning equipment in RCA, the taxpayer's heaters immediate effect is on the surroundings in which the manufacturing takes place, and only remotely on the raw materials. Therefore, the cost of repairs for the heaters is not exempt from use tax because the heaters are not exempt equipment.

B. Fuel Purchases in 1997 (Plant #5160)

The taxpayer agrees that fuel purchases it made in 1997 are taxable but argues that the inclusion of those invoices in the use tax sample projection renders the projection inaccurate. The taxpayer had paid sales tax on fuel purchases during the audit period prior to 1997. Since the sample projection was computed by reviewing invoices from 1997 only, the taxpayer argues that the projection is not an accurate representation for the entire audit period. The taxpayer is sustained on this issue pending audit review.

C. Propane Fuel Purchased for Forklifts (Plant #5182)

The taxpayer was assessed use tax on purchases of propane fuel used to power forklifts. The audit report indicates that the forklifts were used outside of the production process and thus were not exempt equipment, making the fuel used to power them subject to use tax. The taxpayer maintains that the propane fuel purchased is tax exempt because it was used to power two forklifts that were used in the direct production process. The taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-5-12(e) which states:

> Purchases of materials to be consumed during the production or mining process are exempt from tax, if the consumption of such materials has an immediate effect upon the article being produced and mined, or upon machinery, tools, or equipment which are both used in the direct production or mining process and are exempt from tax under these regulations.

The taxpayer maintains that the two forklifts were used to place cement pipes in kilns to be cured and used to assist in removing the outer molds from the pipes, after the curing process, prior to the pipes undergoing further processing. The fuel would be tax exempt if it was consumed in powering exempt equipment. Equipment is exempt if it is directly used in the direct production or manufacture of tangible personal property. Ind. Code § 6-2.5-5-3(b).

Equipment that transports work in progress has been found to meet the requirements of Ind. Code § 6-2.5-5-3. Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 524 (Ind. 1983). In that case, the Indiana Supreme Court found that the equipment used to transport stone from the company's quarry to the crusher and then to stockpiles was directly used in the direct production of tangible personal property. The stone was work in process and the equipment used to move it was tax exempt. As in the Cave Stone case, the taxpayer is using the forklifts to transport cement pipe that is still being processed. The forklifts are exempt and, thus, the fuel to power them is exempt. The taxpayer is sustained on this issue pending audit review.

D. Lease of Communications System (Plants #5142 & 5144)

The taxpayer concedes the use tax assessment on its lease of a communications system in 1997, but argues that this item should be removed from the sample projection because the taxpayer owned its own system prior to 1997. Since the sample projection was computed by reviewing invoices from 1997 only, the taxpayer argues that the projection is not an accurate representation for the entire audit period. The taxpayer is sustained on this issue, pending audit review, as far as the inclusion of the communications system lease in the projection sample. The communications system lease is, however, included in the audit assessment.

E. Invoices for Repair Work Performed on Electric Motors (Plants #5142 & 5144)

The taxpayer argues that repair work performed on electric motors is tax exempt because the motors are components of exempt equipment. Three pieces of equipment were mentioned in the taxpayer's protest letter and described more fully in subsequent information the taxpayer submitted. The palleter is a machine used, prior to the curing process, to form a bell shape on the end of each concrete pipe to allow the pipes to be fitted together. The steam generator produces steam that is used to cure the concrete pipe. The elevator loader is a front-end loader that is used to load raw materials from aggregate piles into the hopper from where the materials are conveyed into the batch plant.

(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.

Ind. Admin. Code tit. 45, r. 2.2-5-8(h)(1 & 2).

Both the palleter and the steam generator are equipment directly used by the taxpayer in the direct production of tangible personal property, that is, the concrete pipes. To the extent that the invoices for the electric motor repairs represent replacement of the motors themselves or the replacement of worn, broken, inoperative, or missing parts, the price paid by the taxpayer for those parts is tax exempt. To the extent that the invoices represent normal repair and maintenance of the electric motors on these pieces of equipment, the amount paid by the taxpayer for the parts is subject to use tax.

The elevator loader moves raw materials into the hopper. Since the production process does not begin until the materials are in the hopper, the job the elevator loader performs is pre-production activity and, thus, this piece of equipment is subject to use tax. The elevator loader is non-exempt machinery therefore, any repairs done to it are subject to use tax.

F. Lease of a Truck (Plants #5142 & 5144)

The taxpayer concedes the use tax assessment on the lease of a truck in 1997, but argues that this item should be removed from the sample projection because the taxpayer owned all of its trucks prior to 1997. Since the sample projection was computed by reviewing invoices from 1997 only, the taxpayer argues that the projection is not an accurate representation for the entire audit period. The taxpayer is sustained on this issue, pending audit review, as far as the inclusion of the truck lease in the sample projection. The truck lease is, however, included in the audit assessment.

FINDING

The taxpayer is sustained, pending audit review, on items B., C., D., and F. The taxpayer is partially sustained pending audit review, and partially denied on issue E. The taxpayer is denied on issue A.

III. Use Tax – Imposition

DISCUSSION

The taxpayer purchased several pieces of equipment during the audit period. The taxpayer protests the assessment of use tax on these items. The purchases in question will be addressed individually.

A. Purchase of Hyster Challenger Forklift, 1994

The taxpayer was assessed use tax on the full purchase price of a Hyster Challenger forklift. The taxpayer claims that the purchase price was not correctly recorded in the audit report. The copy of the invoice submitted by the taxpayer shows the purchase price to be $66,582.00, and not $72,414.00, as shown in the audit report. The taxpayer claims that this forklift is used 40% of the time in production activity and 60% of the time in non-production activities. The production activity consists of removing the cured concrete pipe from the molds prior to finishing work being performed. The non-production activity consists of transporting the finished pipe in the yard and loading the pipe for delivery. The taxpayer claims that it paid tax on 60% of the purchase price and this amount was included in the February 1995 sales tax return.

"Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." Ind. Code § 6-2.5-5-3(b).

The taxpayer is sustained on the issue of the purchase price of the forklift, as shown on the submitted invoice. The taxpayer is also sustained on the issues of percentage of production/non-production use and payment of tax with the February 1995 sales tax return, pending audit verification.

B. Purchase of Two Mack Tractors, 1994

The taxpayer was assessed use tax on its purchase of two Mack tractors. The taxpayer protests the assessment, claiming that it has already paid the tax. The taxpayer has submitted an invoice showing sales tax was paid on the tractors. The taxpayer is sustained on this issue.

C. Purchase of a Hyster Forklift, 1995

The taxpayer was assessed use tax on the full purchase price of a Hyster forklift. The taxpayer claims that the forklift is used 100% of the time in production activities and is thus tax exempt. The taxpayer states that the forklift is used 30% of the time in off-bearing production, that is, the moving of the concrete pipes from the packer-head machine and into the kiln for curing. The taxpayer states that the forklift is used 70% of the time in the tip-out process, that is, the tipping of the cured pipe out of the molds in order that finishing work may be completed.

The use of the forklift is tax exempt under Ind. Code § 6-2.5-5-3 and Ind. Admin. Code tit. 45, r. 2.2-5-8 as machinery directly used in direct production of personal property. The taxpayer is sustained on this issue subject to audit verification.

D. Purchase of Materials Used to Repair Forklift, 1995

The taxpayer was assessed use tax on the cost of repair for a forklift. The taxpayer protests the assessment, claiming that it has already paid the tax. The taxpayer has submitted an invoice showing that sales tax was paid on the repair parts. The invoice separately states the price for the repair parts and the price for the labor. The taxpayer is sustained on this issue.

E. Purchase of Case Loader, 1995

The taxpayer was assessed use tax on the purchase price of a Case loader. The taxpayer protests the assessment because it claims that the tax was already paid. The taxpayer also claims that the loader is used 100% of the time in production activities and is, therefore, tax exempt. The taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-5-8. The taxpayer has submitted an invoice showing that sales tax was paid on the loader. The taxpayer argues that the loader is used 100% of the time to load raw materials onto the batch plant conveying system and that this constitutes the first stage in the production process, making the purchase of the Case loader tax exempt.

The State of Indiana imposes a sales tax on retail transactions in Indiana. Ind. Code § 6-2.5-2-1. In addition, a use tax is imposed on the storage, use, or consumption of tangible personal property in the state. Ind. Code § 6-2.5-3-2. There are, however, exemptions to these taxes. Ind. Code § 6-2.5-5-3(b), known as the equipment exemption, states:

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Additionally, Ind. Admin. Code tit. 45, r. 2.2-5-8(c) states:

> The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

In deciding that the taxpayer was entitled to the equipment exemption, the Indiana Supreme Court in the Cave Stone case found that the equipment used to transport stone from the company's quarry to the crusher and then to stockpiles was directly used in the direct production of tangible personal property. Indiana Dept. of Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 524 (Ind. 1983).

The instant case is distinguishable from the situation described in Cave Stone. In Cave Stone, the taxpayer began the production process by blasting and removing stone from its own quarry. The equipment used to move the stone was transporting unfinished work in process, and thus, exempt. Here, the loading of raw materials onto a conveying system is not part of the production process. The production process begins in the batch plant itself. The loader is being used to introduce raw materials into the beginning of the production process and is not being used to transport unfinished work in process. The loader, as used by the taxpayer in this case, is engaged in pre-production activities and is not a piece of equipment that qualifies for the tax exemption. The taxpayer is sustained on the issue of whether it has already paid the sales tax on the Case loader but denied on the issue of taxability of the equipment.

F. Construction of a New Building, 1996

The taxpayer was assessed use tax on the construction of a new shop building. The taxpayer protests the assessment, claiming that the contract for the construction stated the materials and labor as one price. The taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-3-12 and argues that the contractor is liable for the tax, not the taxpayer. The taxpayer has submitted an invoice showing that the cost of construction of the building was stated as a single price, including materials and labor.

"A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used." Ind. Admin. Code tit. 45, r. 2.2-3-12(d). The invoice submitted by the taxpayer shows a single price, including materials and labor, for the construction of the new shop building. The taxpayer, therefore, is not liable for the tax and is sustained on this issue.

G. Purchase of a Hyster Forklift, 1997

The taxpayer was assessed use tax on the purchase of a Hyster forklift. The taxpayer protests the assessment, claiming that it has already paid the tax. The taxpayer has submitted an invoice showing that sales tax was paid on the purchase. The taxpayer is sustained on this issue.

FINDING

The taxpayer is sustained on issues B., C., D., F., and G. The taxpayer is partially sustained, and partially sustained pending audit verification on issue A. The taxpayer is partially sustained and partially denied on issue E.

IV. Tax Administration – Penalty

DISCUSSION

The taxpayer protests the imposition of a ten percent (10%) negligence penalty for its failure to remit sales and use tax. If a taxpayer incurs a tax deficiency that, upon examination by the Department, is due to negligence, a ten percent (10%) penalty is imposed. Ind. Code § 6-8.1-10-2.1(a & b).

> 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.

Ind. Admin. Code tit. 45, r. 15-11-2(b).

The negligence penalty shall be waived if the taxpayer can show that the failure to remit the tax owed was due to reasonable cause and not due to willful neglect. Ind. Code § 6-8.1-10-2.1(d). The taxpayer has presented no evidence to show that its failure to remit the sales and use taxes it owed was due to reasonable cause. The taxpayer had a use tax accrual procedure in place but dropped it in 1996. Known differences between Indiana sales tax remittances and Indiana taxable sales were unresolved by the taxpayer and significant amounts of use tax were not remitted on several major purchases. As a result, the negligence penalty was properly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980747.LOF

LETTER OF FINDINGS NUMBER: 98-0747
Sales and Use Tax
For Tax Periods: 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales Tax Adjustment – Sales Tax Assessed on Unitary Transactions: Engraving Services

Authority: IC 6-2.5-1-1(a); IC 6-2.5-1-2(a); IC 6-2.5-1-2(b); IC 6-2.5-2-1; IC 6-2.5-2-1(a); IC 6-2.5-2-1(b); IC 6-2.5-4-1(b); IC 6-2.5-4-1(e); 45 IAC 2.2-4-1; 45 IAC 2.2-4-1(b); Cowden & Sons Trucking, Inc. v. Indiana Dept. of State Revenue, 575 N.E.2d 718 (Ind. Tax Ct. 1991); Indiana Dept. of State Revenue v. Martin Marietta Corp., 398 N.E.2d 1313 (Ind. Ct. App. 1979)

Taxpayer protests the imposition of sales tax on that portion of taxpayer's customer invoices attributable to the cost of engraving services.

STATEMENT OF FACTS

Taxpayer is a retailer of engraved trophies, plaques, and sports memorabilia display cases. In association with the sale of those items, the taxpayer provides engraving services. Taxpayer also provides engraving services for customer owned items.

I. Sales Tax Adjustment – Sales Tax Assessed on Unitary Transactions: Engraving Services

The taxpayer protests the assessment of the gross retail tax on that portion of customer invoices attributable to engraving charges. It had been the practice of the taxpayer to list on customer invoices the cost of the trophy (or other item to be engraved) separately from the cost of the engraving and to charge sales tax only for the cost of the trophy. The audit disagreed with the taxpayer's methodology and proposed an additional assessment of gross retail tax on the engraving charges pursuant to 45 IAC 2.2-4-1(b). The audit characterized taxpayer's sales of trophies and engraving services as unitary transactions entirely subject to sales tax. In rebuttal, the taxpayer cites Cowden & Sons Trucking, Inc. v. Indiana Dept. of State Revenue, 575 N.E.2d 718 (Ind. Tax Ct. 1991) for the proposition that the Indiana legislature intended to tax services rendered in a retail unitary transaction only if the transfer of property and rendition of services is inextricable and indivisible. Therefore, according to taxpayer, because the taxpayer's invoices separately stated charges for the cost of the tangible personal property and engraving services, the two costs are demonstrably neither inextricable nor indivisible. Alternatively, the taxpayer requests that the Department apply the audit's determination, that engraving services are subject to sales tax, prospectively. Although taxpayer has agreed to begin charging sales tax for engraving services, the taxpayer has requested that the sales tax assessment for engraving charges made during 1995, 1996, and 1997 be waived. Taxpayer predicates this request on its purported good faith application of the tax law prior to the audit and because the audit's assessment is allegedly based on an attenuated interpretation of a "gray" area of the law.

The Indiana state gross retail tax "is imposed on retail transactions made in Indiana." IC 6-2.5-2-1(a). The term "retail transaction" is defined as a "transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-2, or that is described in any other section of IC 6-2.5-4" IC 6-2.5-1-2(a). "Selling at retail" is defined in IC 6-2.5-4-1(b).

> A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he: (1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration. IC 6-2.5-4-1(b).

Since the sales and use tax statutes expressly state that the transfer of tangible personal property is taxable, by implication the transfer of services is not taxable. However, services are taxable if the services comprise a part of a unitary transaction that is also a retail transaction. IC 6-2.5-1-2(a). IC 6-2.5-4-1(e) states that "[t]he gross retail income received from selling at retail is only taxable... to the extent that the income represents: (1) the price of the property transferred, without the rendition of any service; and

(2)... any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery or *other service performed in respect to the property transferred before its transfer* and which are separately stated on the transferor's records." (Emphasis added).

Under 45 IAC 2.2-4-1 which states, "[w]here ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a 'retail merchant.' (b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to (1) The price arrived at between purchaser and seller. (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or *other services performed in respect to or labor charges for work done with respect to such property prior to its transfer*. (3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller *prior to transfer of such property* at retail." (Emphasis added).

The audit correctly determined that taxpayer's engraving charges are subject to the Indiana gross retail tax. Taxpayer is a retail merchant making retail transactions consisting of the transfer of tangible personal property for which the engraving is a tangential yet inseparable element. When the taxpayer delivers a completed trophy to one of its customers, taxpayer delivers a complete "package" having a unique and indivisible value to that customer. Under 45 IAC 2.2-4-1, when tangible personal property is sold at retail, all the elements of the price are subject to sales tax including any additional charges for services performed, with respect to that property, prior to the transfer of the property.

Taxpayer's reliance on Cowden, 575 N.E.2d 718 is misplaced. In Cowden, there was every indication that the customers bargained for delivery and the sale of the stone separately. Unlike the Cowden transactions, taxpayer performed services prior to the transfer of the personal property.

Indiana imposes on retail merchants the responsibility for collecting the state gross retail tax. IC 6-2.5-2-1. Under that statute, the taxpayer is charged with the duty to "collect the tax as an agent for the state." IC 6-2.5-2-1(b). The Department of Revenue lacks the authority to waive this statutory responsibility and, therefore, taxpayer's request for prospective treatment of the tax assessment must be denied.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04990036.LOF

LETTER OF FINDINGS NUMBER: 99-0036
Sales and Use Tax
For Tax Periods: 1995-1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Like Kind Exchange

Authority: IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-1-5; IC 6-2.5-1-6

Taxpayer protests the imposition of gross retail tax the value of certain trade-ins.

2. Sales and Use Tax – Purchase for Resale Exemption

Authority: IC 6-2.5-3-2(a); IC 6–2.5-5-8; IC 6-8.1-5-1(b)

Taxpayer protests the imposition of gross retail tax on an airplane.

STATEMENT OF FACTS

Taxpayer is in the business of selling, servicing and repairing recreational vehicles along with over the counter sales of parts and accessories. After an audit, additional sales and use tax, interest and penalty were assessed. Taxpayer protested a portion of the assessment and a hearing was held. Further facts will be provided as necessary.

DISCUSSION

1. Sales and Use Tax – Like Kind Exchange

Indiana imposes a sales tax on retail sales. IC 6-2.5-2-1. The sales tax is measured by the gross retail income received by the retail merchant from the purchaser. IC 6-2.5-2-2. Gross retail income does not include the value of "any tangible personal property received in a like kind exchange..." IC 6-2.5-1-5. A like kind exchange is the exchange of personal property of the "same kind or character, regardless of grade or character." IC 6-2.5-1-6.

Taxpayer accepts trade-ins to reduce a portion of the purchase price of its recreational vehicles. If those trade-ins qualify as a like kind exchange under the law, the value of the trade-in is deducted from the total sales price before the sales tax is applied to the cash paid in the transaction. Additional sales tax was assessed on the value of the trade-in in fourteen transactions which the

Auditor did not consider the trade-in to be a like kind exchange.

In one instance a customer purchased a travel trailer with a side trailer as the trade-in. Both of these items were trailers. Therefore, they qualify for like kind exchange treatment. Taxpayer's protest to the assessment of additional tax on the exchange of a side trailer for a travel trailer is sustained.

In another instance Taxpayer accepted jet skis as a trade-in for a 5th wheel trailer. Jet skis are for water recreation and are not of the same character as a trailer. Therefore, this transaction did not qualify for the like kind exchange treatment. Taxpayer's protest to this assessment is denied.

Taxpayer also accepted a boat as a trade-in for a motor home. A boat is a watercraft. A motor home is a motor vehicle. These are not items of the same kind. Therefore the transaction does not qualify for the like kind exchange treatment. Taxpayer's protest to this assessment is denied.

Each of the other purchases included the trade of one motor vehicle for another. Each of the motor vehicles required licensing to be driven on the public highway. It doesn't matter if the motor vehicle is a pick-up truck, a motor home, or an automobile. Taxpayer's protest to the assessment of additional sales tax on these transactions is sustained.

FINDING

Taxpayer's protest is sustained in part and denied in part.

2. Sales and Use Tax – Purchase for Resale Exemption

In 1996 Taxpayer purchased an airplane without paying sales or use tax. IC 6-2.5-3-2 (a) imposes the state gross retail or use tax "on the storage, use, or consumption of tangible personal property in Indiana." There are several statutory exemptions to the use tax. Taxpayer contends that its purchase and use of the airplane qualifies for exemption pursuant to IC 6-2.5-5-8 as follows:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

The tax assessment is presumed to be correct. Taxpayer bears the burden of proving that the assessment is incorrect and the airplane qualifies for the resale exemption. IC 6-8.1-5-1(b). Taxpayer submitted a copy of its aircraft dealer license, documentation that the dealer aircraft inventory tax was paid on this airplane, copies of advertisements for this and another airplane and evidence that the subject airplane was actually sold. These documents do not, however, establish why it was three years before the airplane was sold. Nor do they explain why the plane was insured for business and personal use. This evidence indicates that Taxpayer's acquisition and use of the airplane was at least partially for personal use. Therefore the purchase of the airplane did not qualify for the resale exemption.

FINDING

Taxpayer's second point of protest is denied.

DEPARTMENT OF STATE REVENUE

04990042.LOF

LETTER OF FINDINGS NUMBER 99-0042
Sales And Use Tax
For Tax Periods: 1993-1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

ISSUES

1. Sales and Use Tax – Medical Equipment – Safe Needle Housings

Authority: IC 6-2.5-5-18(a); 45 IAC 2.2-5-28(h)

Taxpayer protests the assessment of tax on the sale of safe needle housings (syringe needle assemblies).

2. Sales and Use Tax – Medical Equipment – Batteries

Authority: IC 6-2.5-5-18(a); 45 IAC 2.2-5-28(h)

Taxpayer protests the assessment of tax on the sale of batteries used to provide power for infusion pumps.

3. Sales and Use Tax – Medical Equipment – IV Stand Rentals
Authority: IC 6-2.5-5-18(b); 45 IAC 2.2-5-29; 45 IAC 2.2-5-28(h)
Taxpayer protests the assessment of tax on the receipts from monthly and daily rentals of IV stands.
4. Sales and Use Tax – Medical Equipment – Urine Drainage Bags
Authority: IC 6-2.5-5-18(d)
Taxpayer protests the assessment of tax on the sale of urine drainage bags.

STATEMENT OF FACTS

Taxpayer sells all drugs, supplies, and equipment necessary to administer various home infusion therapies to patients. The patient or caregiver uses the equipment and supplies to infuse the drugs, all at the patient's home. All drugs, supplies, and equipment are provided to the patient under a physician's prescription. All sales are made directly to the patient; no sales are made to doctors or other third parties. The therapies involved include long-term intravenous antibiotic, antiviral, pain management, or chemotherapy treatments, and enteral or parenteral nutrition programs.

Generally speaking, the State of Indiana imposes a state gross retail tax on retail transactions made in Indiana (IC 6-2.5-2-1). A retail transaction is generally defined as the transfer of tangible personal property for consideration (IC 6-2.5-4-1).

Taxpayer has assessments pursuant to an audit for tax years 1993-1995, inclusive. Taxpayer protests certain of these assessments, and a hearing was held. Further facts will be provided as necessary.

1. Sales and Use Tax – Medical Equipment – Safe Needle Housings

DISCUSSION

Taxpayer's initial point of protest concerns the assessment of tax on the sale of safe needle housings. Safe needle housings (syringe needle assemblies) are safety mechanisms used as part of the delivery system to get medicine into the body. IC 6-2.5-5-18(a) states:

> Sales of artificial limbs, orthopedic devices, dental prosthetic devices, eyeglasses, contact lenses, and other medical equipment, supplies, and devices are exempt from the state gross retail tax, if the sales are prescribed by a person licensed to issue the prescription.

45 IAC 2.2-5-28(h) states:

> The term "medical equipment, supplies or devices", as used in this paragraph, are those items, the use of which is *directly required* to correct or alleviate injury to, malfunction of, or removal of a portion of the purchaser's body. (Emphasis added).

Even though the safe needle housings are prescribed by a physician, the housings do not meet the criteria of medical equipment, supplies, or devices under 45 IAC 2.2-5-28(h) because the safe needle housing is not *directly required* to correct or alleviate anything. The safe needle housings are indirectly used in administering the drugs to the patient because the safety mechanism is not injecting the drug into the patient, but is used as a safety precaution for the safe use and disposal of needles. Thus, the sale of safe needle housings (syringe needle assemblies) is a taxable sale under IC 6-2.5-4-1 and IC 6-2.5-2-1.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Medical Equipment – Batteries

DISCUSSION

Taxpayer's second point of protest concerns the assessment of tax on the sale of batteries used to provide power for infusion pumps. The sale of medical equipment, supplies, and devices are tax-exempt under IC 6-2.5-5-18(a). 45 IAC 2.2-5-28(h) requires that in order to be considered medical equipment, supplies, or devices, an item must be *directly required* in a treatment which corrects or alleviates an injury or malfunction to the patient. The batteries at issue are used for the same primary purposes. They are used in the infusion pumps to either allow patient mobility or provide an auxiliary power system for back-up to power exempt equipment.

FINDING

Taxpayer's protest is sustained.

3. Sales and Use Tax – Medical Equipment – IV Stand Rentals

DISCUSSION

Taxpayer's third point of protest concerns the assessment of tax on the receipts from monthly and daily rentals of IV stands. IC 6-2.5-5-18(b) states:

> Rentals of medical equipment, supplies, and devices are exempt from the state gross retail tax, if the rentals are prescribed by a person licensed to issue the prescription.

See also 45 IAC 2.2-5-29.

45 IAC 2.2-5-28(h) requires that the IV stands be directly required to correct or alleviate the patient's injury or malfunction in order to be considered tax exempt medical equipment, supplies, or devices. The IV stands are used to deliver gravity-controlled disbursements of drugs, thus meeting the regulatory requirement. The daily and monthly rentals of IV stands are tax-exempt under IC 6-2.5-5-18(b).

FINDING

Taxpayer's protest is sustained.

4. Sales and Use Tax – Medical Equipment – Urine Drainage Bags

DISCUSSION

Taxpayer's final point of protest concerns the assessment of sales tax on the sale of urine drainage bags. IC 6-2.5-5-18(d) states: Sales of colostomy bags, ileostomy bags, and the medical equipment, supplies, and devices used in conjunction with those bags are exempt from the state gross retail tax.

Since urine drainage bags are a type of ostomy bag, the sale of these bags is exempt under the statute.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

03990163P.LOF

LETTER OF FINDINGS NUMBER: 99-0163P
Withholding Tax
Calendar Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on a nonresident withholding tax assessment resulting from a Department investigation conducted for the years 1995, 1996, and 1997.

The taxpayer is an Illinois Sub S corporation doing business in Indiana. The taxpayer has two Illinois shareholders.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the negligence penalty should be waived as the taxpayer was unaware that Illinois is not reciprocal with Indiana on non-wage income.

45 IAC 15-11-2(b) 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 finds the taxpayer is inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

04990436.LOF

LETTER OF FINDINGS NUMBER: 99-0436
Sales and Use Tax
For Tax Periods: 1996-1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – Difference in Taxable Sales

Authority: IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-6-7; IC 6-2.5-6-8

Taxpayer protests the assessment of gross income tax on receipts which Taxpayer claims constitute exempt agency receipts.

2. Sales and Use Tax – Bad Debt Deductions
Authority: IC 6-2.5-6-9; 26 U.S.C.A. Sec. 166, 26 CFR Sec. 1.166-1(c)

Taxpayer protests the adjustments made for bad debts.

3. Tax Administration – Penalty
Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a clothing retailer. After an audit, Taxpayer was assessed additional sales and use tax, interest and penalty for the years 1996-1997. Taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax – Difference in Taxable Sales

DISCUSSION

Indiana imposes an excise tax, the gross retail tax, on retail transactions made by retail merchants. The merchant, as agent of the state, collects the tax from the purchaser. IC 6-2.5-2-1. The measure of the tax is the total gross retail income received in taxable transactions by the merchant. Tax applies at a rate of 5% of the gross retail income on each taxable transaction, rounded to the nearest whole cent. IC 6-2.5-2-2. The amount of a retail merchant's tax liability is determined pursuant to the following provisions of IC 6-2.5-6-7.

> Except as otherwise provided in IC 6-2.5-7 or in this chapter, a retail merchant shall pay to the department, for a particular reporting period, an amount equal to the product of:
> (1) five percent (5%); multiplied by
> (2) the retail merchant's total gross retail income from taxable transactions made during the reporting period.
> The amount determined under this section is the retail merchant's state gross retail and use tax liability regardless of the amount of tax he actually collects.

In the audit, the Department Auditor calculated the amount of sales tax due by multiplying Taxpayer's gross retail income as indicated in the sales journals by the tax rate of five percent (5%). Taxpayer testified that its computer registers computed the sales tax charged on each individual sale. The registers then calculated the total amount of sales tax collected on the individual transactions during the month. Taxpayer entered this number on the line on the ST 103 for tax to be paid to the state. Taxpayer then calculated the gross retail sales from this sales tax figure to enter onto the line for gross retail sales on the ST 103. Taxpayer argues, but was unable to substantiate, that the difference in sales tax as determined in the audit and as determined in Taxpayer's filings is attributed to the rounding to the nearest whole cent of tax on the sales tax chart issued by the Department. Taxpayer contends that its process reflects the proper amount of sales tax to be remitted to the state and that the Department process overstated the sales tax to be remitted.

IC 6-2.5-6-8 provides for an "income exclusion ratio" to adjust the sales tax liability. The enactment of this law indicates that the legislature was aware of the discrepancy between the two formulas for determining the sales tax liability.

The method of computation of the proper amount of tax to remit to Indiana is set out at IC 6-2.5-6-7 as previously cited. The Auditor correctly used this statutory procedure to compute Taxpayer's sales tax liability.

FINDING

Taxpayer's protest is denied.

2. Sales and Use Tax – Bad Debt Deductions

DISCUSSION

During the tax period, Taxpayer had an agreement with a related factoring company and bank to administer Taxpayer's proprietary credit card program. Taxpayer's customers used credit cards issued in Taxpayer's name to finance purchases at Taxpayer's retail stores. Pursuant to the agreements, Taxpayer sold to the factoring companies the credit slips for the amounts shown thereon less a discount equal to the bad debt percentage incurred in the previous year and the rights to collect on the debts. At the end of each fiscal year the payments were "trued up,", i.e., Taxpayer and the factoring company determined the actual amount of bad debt losses arising from credit card transactions during the year and adjusted the payments accordingly. The agreement expressly made Taxpayer responsible for all bad debts with respect to transactions under the agreement. At this point, Taxpayer does not retain recourse against the customers. Taxpayer wrote the bad debts off on their federal adjusted gross income tax returns and claimed the bad debt deduction on their sales tax returns. The bad debt deduction was disallowed in the audit report.

The sales tax law provides for a bad debt deduction at IC 6-2.5-6-9 as follows:

> In determining the amount of state gross retail and use taxes which he must remit..., a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:
> (1) Resulted from retail transaction in which the retail merchant did not collect the state gross retail or use tax from the purchaser;
> (2) Resulted from retail transaction on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and
> (3) Were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

In this instance, Taxpayer clearly meets the first two requirements. It paid the sales tax to Indiana but did not ever collect it from the purchaser. The issue to be determined is whether Taxpayer meets the third requirement for the deduction of bad debts.

26 U.S.C.A. Sec. 166 allows for the deduction of a bona fide debt from adjusted gross income tax. The term "bona fide debt" is explained at 26 CFR Sec. 1.166-1(c) as a debt which is "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money."

In this case, Taxpayer sells the account receivables to another entity. Customers actually owe the debt to the bank. Pursuant to the submitted agreements, the bank has the right to collect the debt from the purchasers of Taxpayer's product. Taxpayer does not have that right. Therefore, Taxpayer has no recourse against the customers who do not fulfill their obligations to satisfy their credit card liabilities. Pursuant to the terms of the federal law and regulations, the bona fide debt is between the customer and the bank. Taxpayer does not have a bona fide debt and cannot write off bad debts for adjusted gross income tax purposes. Taxpayer does not meet the third requirement to deduct bad debts for sales tax purposes.

FINDING

Taxpayer's second point of protest is denied.

3. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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.

In this instance, Taxpayer failed to follow the instructions of the department in the way it reported its sales tax liability. This breach of its duty to properly report and remit sales taxes constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01990479P.LOF

LETTER OF FINDINGS NUMBER: 99-0479P
Income Tax
Calendar Year 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

The taxpayer protests the penalty assessed.

STATEMENT OF FACTS

The negligence penalty was assessed on a late filing of the Indiana Nonresident income tax return.

The taxpayer is an Illinois taxpayer with income in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the penalty should be waived as the taxpayer was unaware of the need to file an Indiana income tax return, and, when notified by his accountant, the taxpayer filed the tax return immediately. The Department points out the income tax return was filed on June 30, 1999, more than a year after the due date of the income tax return.

45 IAC 15-11-2(b) 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 finds the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the negligence penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

01990499.LOF

LETTER OF FINDINGS NUMBER: 99-0499 AGI
Adjusted Gross Income Tax
For Tax Periods: 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Adjusted Gross Income Tax – Imposition

Authority: IC 6-3-2-1; IC 6-3-1-3.5; 26 U.S.C.A. Sec. 61

Taxpayer protests the imposition of the adjusted gross income tax on a portion of his income.

STATEMENT OF FACTS

Taxpayer protested an assessment of Indiana Adjusted Gross Income Tax on certain income received in 1997. Further facts will be provided as necessary.

Adjusted Gross Income Tax – Imposition

DISCUSSION

Taxpayer was a professional athlete from 1986 through 1988 and a resident of a state other than Indiana. During this time period, Taxpayer became a victim of collusive practices by ownership and management of the professional sport. Therefore, he became entitled to a settlement, which was paid in 1997.

Taxpayer filed a 1997 federal income tax form reporting federal adjusted gross income of $163,740. Taxpayer filed a 1997 Indiana state tax return reporting total Indiana income of $70,574. The difference of $93,166 represents amounts received in 1997 from the settlement.

Indiana imposes an adjusted gross income tax on income received by Indiana residents during a tax year. IC 6-3-2-1. In determining their Indiana adjusted gross income, Indiana residents start with their federal adjusted gross income and make certain statutorily defined modifications. IC 6-3-1-3.5. Taxpayer reported $163,740 as his federal adjusted gross income in 1997. This included $93,166 received as a settlement from the lawsuit. This amount was compensation for his personal services for an employer. As such, this amount is included in Taxpayer's gross income in the year of receipt. 26 U.S.C.A. Sec. 61. To determine his Indiana adjusted gross income, Taxpayer should have reported the same $163,740. Rather, Taxpayer deducted a portion of the income he received in 1997. This resulted in an artificially low Indiana adjusted gross income and an underpayment of Indiana Adjusted Gross Income Tax.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990634.LOF

LETTER OF FINDINGS NUMBER: 99-0634
Sales and Use Tax
For Tax Periods: 1996-1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

1. Sales and Use Tax – All Terrain Vehicles

Authority: IC 6-2.5.5-2; IC 6-8.1-5-1(b); IC 6-2.5-3-2 (a)(3); 45 IAC 2.2-5-3 (e)(3); 45 IAC 2.2-5-1(c)(3); 45 IAC 2.2-5-1(a); 45 IAC 2.2-5-1(a); Gross Income Tax Division v. National Bank and Trust Co., (1948) 226 Ind. 298, 79 N.E. 2d 651

Taxpayer protests the assessment of gross retail tax on purchases of two all terrain vehicles.

STATEMENT OF FACTS

Taxpayer is a Kentucky tree and grain farmer. In 1996 and 1997 he bought all terrain vehicles from an Indiana dealership. After an audit of the Indiana dealership, the Indiana Department of Revenue assessed gross retail tax on Taxpayer's purchases of the all terrain vehicles. Taxpayer protested the assessment. More facts will be provided as necessary.

1. Sales and Use Tax – All Terrain Vehicles

DISCUSSION

Pursuant to IC 6-2.5-3-2(a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., (1948) 226 Ind. 298, 79 N.E.2d 651. Taxpayer contends that the purchases of the all terrain vehicles qualify for exemption pursuant to the agricultural exemption found at IC 6-2.5-5-2 as follows:

> (a) Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

This exemption applies to "those persons occupationally engaged in producing food or agricultural commodities for sale." 45 IAC 2.2-5-1(a). Taxpayer is engaged in the growing of grain and oak trees for sale. Therefore, Taxpayer is one of the persons who can purchase equipment which qualifies for this exemption. The statute states that the exemption applies to machinery that is directly used in the direct production of agricultural commodities. To qualify for this exemption, the equipment "must have an immediate effect on the article being produced." 45 IAC 2.2-5-1(a). Machinery meets this test "if it is an essential and integral part of an integrated process which produces food or an agricultural commodity." 45 IAC 2.2-5-1(a). If equipment is used in both an exempt and non exempt manner, it qualifies for exemption in proportion to the amount of exempt use. 45 IAC 2.2-5-1(c)(3). The issue to be determined is whether any or all of the use of the all terrain vehicles qualifies for exemption.

The first all terrain vehicle was purchased to replace a tractor. The second all terrain vehicle was purchased to replace the first all terrain vehicle after it was of no further use. The all terrain vehicles look like golf carts. They have no cab, turn signals or brake lights. They cannot legally be driven on the public highways.

Taxpayer uses the all terrain vehicles a portion of the time to pull a trailer and transport tools and supplies. This is clearly a taxable use of the vehicles since it does not directly effect the process of growing trees and grain. Taxpayer also uses the all terrain vehicles to construct and check fencing. The exempt use of fencing is clarified at 45 IAC 2.2-5-3(e)(3) as follows:

> Fences, fencing materials, gates, posts, and electric fence chargers are exempt only if the same are purchased for use in confining livestock during the production processes of breeding, gestation, farrowing, calving, nursing, or finishing... Fencing materials are also taxable if the fence is used only as a partition fence between adjoining landowners or as a means to keep wildlife, stray animals, or trespassers from entering cropland or farm premises.

Taxpayer uses the fencing to separate his farm from other farms. He specifically uses it to designate the boundaries of his property and to keep stray animals out of his croplands and tree growing acreage. These are clearly taxable uses. Any use of the all terrain vehicles to construct or check fence would also be taxable. Taxpayer bears the burden of proving the percentage of the all terrain vehicle's use that is used in an exempt manner pursuant to IC 6-8.1-5-1(b) as follows:

> 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.

Taxpayer did not provide adequate substantiation of the proportion of the time the all terrain vehicles are used for transportation of tools, checking fence lines and construction of new fence. Taxpayer did not sustain his burden of proving the percentage of time the all terrain vehicles are used in exempt manners. Therefore Taxpayer's protest of the percentage of the use of the all terrain vehicles which would qualify them for exemption is denied.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01990644P.LOF

LETTER OF FINDINGS NUMBER: 99-0644P
Individual Income Tax
Calendar Years 1992, 1993, 1994, 1995, and 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

The taxpayer protests the penalty assessed.

STATEMENT OF FACTS

The negligence penalty was assessed on an income assessment resulting from a Department audit conducted for the calendar years 1992, 1993, 1994, 1995, & 1996.

The taxpayer is an Illinois taxpayer with income in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as the taxpayer was unaware of Indiana tax regulations requiring the filing of an Indiana tax return, and, the taxpayer had a serious stroke in 1993.

With regard to the illness issue, Indiana follows Federal guidelines with regard to taxes. Federal tax regulations (i.e. Williams v. Commissioner, 16 T.C. 893, 906 (1951)) state penalty may be waived in the event the taxpayer has an illness where the taxpayer is continuously incapacitated. In this case, the taxpayer had a stroke in 1993 yet was able to file a 1993 income tax return. Clearly, the taxpayer was not incapacitated to the point where an income tax return could not be filed. As such, the Department finds the illness issue invalid grounds for waiving the penalty.

With regard to ignorance of Indiana tax laws, Indiana tax regulation 45 IAC 15-11-2 states ignorance is negligence and negligence is subject to penalty. On this issue, the penalty is denied.

To conclude, the Department finds the penalty proper, and therefore, denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0420000103.LOF

LETTER OF FINDINGS NUMBER: 00-0103
Sales and Use Tax
For Tax Periods: 1996-1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

1. Sales and Use Tax – Purchase for Resale Exemption

Authority: IC 6-2.5-3-2(a); IC 6-2.5-5-8; IC 26-1-2-106; USAir, Inc. v. Indiana Department of Revenue, 542 N.E.2d 1033 (Tax Court 1989)

Taxpayer protests the imposition of gross retail tax on crayons.

2. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 2.2-3-16

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer owns and operates several restaurants in Indiana and Ohio. After an audit, additional sales and use tax was assessed. Taxpayer protested a portion of the assessment and a hearing was held. Further facts will be provided as necessary.

1. Sales and Use Tax – Purchase for Resale Exemption

DISCUSSION

Taxpayer provides crayons and activity sheets to children in its full service restaurants in hopes that the children will be entertained while the parents are ordering and dining.

The Indiana Department of Revenue assessed use tax on the crayons. Taxpayer protests this assessment.

IC 6-2.5-3-2 (a) imposes the state gross retail or use tax "on the storage, use, or consumption of tangible personal property in Indiana." There are several statutory exemptions to the use tax. Taxpayer contends that its purchases of crayons qualify for exemption pursuant to IC 6-2.5-5-8 as follows:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

Taxpayer argues that it actually sells the crayons as part of the meal. Crayons are offered to all children eating in the restaurants. Taxpayer's policy is to encourage children to use the crayons in the restaurant and then take them home after the dining experience. Taxpayer collects and remits sales tax based upon the total sales price of the meals including crayons.

Taxpayer's situation is similar to the situation of USAir in the case USAir, Inc. v. Indiana Department of Revenue, 542 N.E.2d 1033 (Tax Court 1989). In that case, USAir claimed a resale exemption for the meals which it purchased and served to passengers on its flights. The Court held that passengers did not bargain separately or pay separate consideration for the meals. No passenger would be able to refuse service of the meal and then deduct the cost of his meal from the price of the ticket. Rather the meals were an amenity and ordinary cost of doing business. USAir used the meals in the performance of its business of providing air transportation to passengers. The Court concluded that the meals did not qualify for the resale exemption. Likewise, diners in Taxpayer's restaurants do not bargain separately or pay separate consideration for the crayons. Rather the crayons are an ordinary cost of doing business. Taxpayer uses the crayons in its business of selling meals to families.

FINDING

Taxpayer's protest is denied.

2. Tax Administration – Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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.

In this instance, Taxpayer failed to pay gross retail tax on many items clearly subject to this tax. These items include coffee urns for serving, office supplies, shirts and menu covers. This breach of its duty to properly report and remit gross retail tax constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

2820000243.LOF

LETTER OF FINDINGS NUMBER: 00-0243 CSET
Controlled Substance Excise Tax
For Tax Periods: 1999-2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

1. Controlled Substance Excise Tax – Constitutionality

Authority: 4th, 5th, 6th, 8th and 14th Amendments to the United States Constitution and Article l, Sections 1, 11,12,113, 14, 16 and 21 of the Indiana Constitution

Taxpayer contends that the Controlled Substance Excise Tax is unconstitutional.

2. Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-5; IC 6-8.1-5-1(b)

Taxpayer protests the imposition of the Controlled Substance Excise Tax.

3. Controlled Substance Excise Tax – Double Jeopardy

Authority: 5th and 14th Amendments to the United States Constitution, Bryant v. State of Indiana, 660 N.E. 2d 290 (Ind. 1995)

Taxpayer contends that this imposition of the Controlled Substance Excise Tax places him in jeopardy twice for the same offense.

STATEMENT OF FACTS

Taxpayer was arrested for possession of marijuana on February 3, 2000. On May 8, 2000, the county prosecutor sent the Indiana Department of Revenue a letter stating that he would not press criminal charges concerning the boxes of marijuana received in Indiana prior to February 3, 2000. The Indiana Department of Revenue issued a record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on May 10, 2000, in a base tax amount of $327,356.72. Taxpayer filed a protest to the assessment. A hearing on the protest was August 23, 2000. Further facts will be provided as necessary.

1. Controlled Substance Excise Tax – Constitutionality

DISCUSSION

Taxpayer contends that this assessment of the Controlled Substance Excise Tax violates his federal constitutional rights guaranteed by the 4th, 5th, 6th, 8th and 14th Amendments to the United States Constitution and state constitutional rights guaranteed by Article l, Sections 1, 11,12,113, 14, 16 and 21 of the Indiana Constitution.

An administrative hearing in the agency charged with the implementation and enforcement of a state tax law is not the proper forum to challenge the constitutionality of the state law.

FINDING

Taxpayer's protest is denied.

2. Controlled Substance Excise Tax – Imposition

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of marijuana in the State of Indiana. Indiana Department of Revenue assessments are presumed to be correct and Taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b).

In a police interview, Taxpayer stated that on several occasions he sent money to California and received a package of marijuana in return. The US Postal Inspection Service Parcel Watch for the area where Taxpayer lived included six parcels which had Taxpayer's name on them as sender, addressee or signatory. Those parcels were received on June 6, 1999; October 13, 1999; November 15, 1999; November 20, 1999; November 24, 1999 and January 21, 2000. Taxpayer possessed each of these parcels of marijuana. Taxpayer's protest to the imposition of the Controlled Substance Excise Tax on these parcels is denied.

There is not sufficient evidence that Taxpayer actually possessed the other parcels of marijuana listed on the US Postal Inspection Service Parcel Watch to assess the Controlled Substance Excise Tax. Taxpayer's protest to the tax assessed on these parcels is sustained.

Taxpayer also contests the amount of the assessment. The Indiana Department of Revenue used estimates of the weights of some of the parcels of marijuana in determining the amount of tax due to the state. Taxpayer did not submit any evidence of actual weights. Taxpayer did not meet his burden of proof that the weights used in determining the amount of the assessment were inaccurate. This point of Taxpayer's protest is denied.

FINDING

Taxpayer's protest is denied in part and sustained in part.

3. Controlled Substance Excise Tax – Double Jeopardy

DISCUSSION

The Fifth and Fourteenth Amendments of the United States Constitution prohibit placing any citizen in jeopardy twice for the same action. Jeopardy attaches when a determination of guilt is made and a person is put at risk of punishment. Bryant v. State of Indiana, 660 N.E. 2d 290,(Ind. 1995). In the instant case, Taxpayer was criminally prosecuted for a possession of marijuana on February 3, 2000. No Controlled Substance Excise Tax was imposed on the possession of marijuana on February 3, 2000. Tax was only imposed on separate possessions prior to February 3, 2000. Therefore, the Indiana Department of Revenue did not violate Taxpayer's rights pursuant to the Fifth and Fourteenth Amendments to the United States Constitution.

Taxpayer alternatively argues that even if there were no actual violation of Taxpayer's constitutional right against double jeopardy, he felt like he was placed in jeopardy twice for the same offence. Taxpayer's perception that he was placed in double jeopardy despite the reality does not provide an adequate basis for relief.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000270P.LOF

LETTER OF FINDINGS NUMBER: 00-0270P

Sales Tax and Use Tax
For Calendar Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on March 3, 2000 for audit years 1995, 1996, and 1997.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer failed to remit 3.9%, 4.8%, and 4.6% of its sales tax due, and 3.7%, 29.1%, and 27.3% of its use tax for calendar years 1995, 1996, and 1997 respectively. A review of the audit report indicates the assessments stemmed from taxpayer's inclusion of taxable items such as copying, printing, desktop publishing, color copies, etc. in exempt sales. Taxpayer also failed to self assess use tax on fixed assets such as carpet, computer equipment and related products.

Taxpayer requests a waiver of penalties because it exercises due care in obtaining exemption certificates and in verifying exempt sales and further states that the number of transactions along with the number of individuals involved in exempt sale matters makes complete compliance extremely difficult. Taxpayer states that the liability is well within the realm of materiality and is less than 4.2% of taxes remitted during the audit period and indicates it has acted with reasonable cause and that the penalty should be abated in full.

Taxpayer failed to collect and remit tax on clearly taxable sales and failed to self assess use tax on clearly taxable purchases. The taxpayer was negligent in failing to self-assess and remit taxes and has not provided reasonable cause for failure to do so.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000334.LOF

LETTER OF FINDINGS NUMBER: 00-0334
Adjusted Gross Income Tax
For Calendar Year 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer failed to timely file its Indiana income tax return for the tax year ending December 31, 1997. The department issued a penalty billing.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer, at hearing, states that the company did not make money, did not owe income tax, and is now out of business.

Based upon the above information, taxpayer requests that the penalty be waived.

Taxpayer failed to timely file its IT20-S return for calendar year 1997.

IC 6-8.1-10-2.1(g) states:

A person who fails to file a return for a listed tax that shows no tax liability for a taxable year, other than an information return (as defined in section 6 of this chapter), on or before the due date of the return shall pay a penalty of ten dollars ($10) for each day that the return is past due, up to a maximum of two hundred fifty dollars ($250).

Taxpayer failed to file its return timely. The department finds that a negligence penalty is proper.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000341P.LOF

LETTER OF FINDINGS NUMBER: 00-0341P
Use Tax
Calendar Years 1997, 1998, 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on May 24, 2000.

Taxpayer is an Indiana corporation. At audit, it was discovered that the taxpayer had no use tax accrual system in place.

I. Tax Administration – Penalty

DISCUSSION

At issue is whether the taxpayer was negligent in failing to remit use tax due.

Taxpayer failed to remit use tax on clearly taxable items and had no use tax accrual system in place.

Taxpayer states it was in substantial compliance and the tax assessed was minor.

Department records indicate the taxpayer self-assessed no use tax. In addition, taxpayer has not provided reasonable cause for failing to self assess tax.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000342P.LOF

LETTER OF FINDINGS NUMBER: 00-0342P
IT-20 Penalty
For Fiscal Year Ended July 31, 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer filed its fiscal year tax return on the due date of May 15, 2000 and remitted the tax on Monday, May 22, 2000. The payment was late.

Taxpayer protests the penalty and states there was a misunderstanding as it assumed the payment was due on the 20^{th} of the month, as is its quarterly installment payment and monthly sales/use tax payment. To compound the problem, taxpayer states it recently merged with a sister cooperative and installed two new general ledger systems, all in the same fiscal year.

Taxpayer's representative, in a letter dated August 28, 2000 requested a penalty waiver due to reasonable cause and states the taxpayer's explanation should establish reasonable cause. However, it wishes to add to taxpayer's letter dated August 16, 2000 and states there was confusion over the due date for a cooperative return. Taxpayer states that in researching the issue, it discovered that the Department of Revenue had inadvertently used the wrong due date when they re-codified the regulations in October of 1998. The normal due date for a cooperative for federal income tax purposes is eight and one-half months after their year end. The state return is due one month later or nine and one-half months after their year-end. The Indiana regulations were incorrect. All cooperative returns were beginning to show up as having late filing penalties.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states the facts and circumstances related to taxpayer's original protest letter coupled with the department's inadvertent error should be enough to establish reasonable cause.

Taxpayer was assessed a late payment penalty because if failed to make payment by the due date of the tax return. IC 6-8.1-10-2(a) clearly states that a penalty is assessed for the failure to pay the full amount of tax shown on a return on or before the due date for the return. The return was due on May 15, 2000 or nine and one-half months after year-end. Taxpayer made no payment until May 22, 2000.

The department finds that a negligence penalty is proper.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02950265.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 95-0265 IT
Gross Income Tax – Receipts Received by Agents
For Tax Periods: 1991 through 1993

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax – Receipts in an Agency Capacity

Authority: IC 6-2.1-1-2(a); 45 IAC 1-1-54; *Universal Group Limited v. Indiana Department of State Revenue*, 642 N.E.2d 553, 558 (Ind.Tax 1994)

Taxpayer protests the proposed assessment of gross income tax on reimbursements for wages, employment taxes, and other employment benefits "advanced" to its employees.

STATEMENT OF FACTS

Taxpayer, an entity incorporated and domiciled in Indiana, operated under four divisions during the audit period. Taxpayer provided payroll and centralized management services for these divisions. Taxpayer also provided similar services for two corporations. Taxpayer was reimbursed for costs incurred. At issue was the characterization, for gross income tax purposes, of these reimbursements.

Audit determined the "reimbursements" represented taxable income and proposed additional gross income tax assessments. IC 6-2.1-1-2(a). At the initial hearing, Taxpayer argued such "reimbursements" were properly excluded from its taxable gross income, pursuant to 45 IAC 1-1-54, as the income was received in an agency capacity.

In upholding the proposed assessments, the Department stated:

> Because taxpayer retained the reimbursements and used the money it received to pay its own employees, the taxpayer was not acting simply as a conduit through which the money passed….[Therefore,] the receipts received by the taxpayer for the reimbursement of payroll services rendered must be included in taxpayer's taxable gross income.

Taxpayer subsequently protested the Department's findings and timely requested a rehearing.

I. Gross Income Tax – Receipts in an Agency Capacity

DISCUSSION

Taxpayer takes exception to two (2) of the Department's conclusions. First, Taxpayer interprets the Department's findings as condoning the taxation of "inter-divisional" transfers. As Taxpayer explains:

> [T]he Department contends certain [inter]-divisional transfers are gross income. The Taxpayer operates a number of divisions within its corporate structure. The Taxpayer maintains a certain level of accounting for each of these divisions as a management tool. Otherwise, these divisions make up one legal entity….Both the real estate division and the restaurant division maintain

separate checking accounts in the [respective] division's name. Although the checking account is in the division's d/b/a (doing business as) name, the federal identification number provided to the bank and on each account is the Taxpayer's federal identification number. There are periodic transfers between the Taxpayer's checking accounts. These transfers should not be subject to gross income tax.

And second, Taxpayer protests the inclusion of "reimbursements" from other corporate entities in its state gross income calculus. Again, Taxpayer explains:

Taxpayer and [Corporation A] and [Corporation B], each separate legal entities, operate from the same office….To avoid substantial duplication of services and personnel hours, all wages for the employees that work on behalf of [Corporation A] and [Corporation B] are paid by the Taxpayer under a management agreement between the Taxpayer and [Corporation A] and [Corporation B]. Both [Corporation A] and [Corporation B], in turn, reimburse the Taxpayer in an amount equal to the wages paid the employees working on each respective entity's behalf.

The Department notes, as a preliminary matter, that the initial letter of findings did not contain language dictating the inclusion of "inter-divisional" or "intra-corporate" transfers in Taxpayer's taxable gross income. To the extent such an interpretation was made, it is in error.

In the initial letter of findings, the Department determined reimbursements for employee services provided to third parties represented prima facie evidence indicating the income did not "pass through" to another. The Department found that Taxpayer (as employer) received a beneficial interest in the "reimbursements" because the income was used by Taxpayer to pay its own expenses—i.e., used to meet its payroll obligations. In other words, the income did not "pass through" to a third party; Taxpayer was not receiving this income in a agency capacity. The Department based its conclusion on language offered by the Indiana Tax Court in a case with seemingly analogous facts:

[A]ssuming *arguendo* the arrangements created agency relationships, there was no pass through. The reimbursements to the corporations that performed the administrative tasks were reimbursements for those corporations' own expenses, **such as paying their own employees' wages**, not for monies advanced to third parties.

Indeed, the entire beneficial interest in the reimbursements lies with the parties receiving the reimbursements. **That these are true reimbursements without any profit to the recipient is irrelevant:** "[t]he gross income tax is applicable regardless of any profit being involved." *Western Adjustment* 236 Ind. at 645, 142 N.E.2d at 633. Whether these transactions should be taxable, as a matter of tax policy, is a matter for the legislature, not this court (emphasis added).

Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553, 558 (Ind.Tax 1994).

Taxpayer argues an employer receiving "reimbursements" for wages paid to its own employees working for another does not, on its face, represent a "beneficial interest." Taxpayer prefers a less dogmatic, more pragmatic, conceptualization of "beneficial interest." Rather than focusing on the employee-employer relationship, Taxpayer suggests "[t]he most important factor in determining whether the agency receipts [i.e., reimbursements] are taxable is [determining] whether the agent [employer] benefited directly from the receipts." Taxpayer argues that under this more "pragmatic" approach, no beneficial interest accrued.

The Department finds merit in Taxpayer's argument. Taxpayer employed a certain number of employees; these employees performed work exclusively for Corporation A and Corporation B. Taxpayer received reimbursements for its own payroll expenses from Corporation A and Corporation B. The employees, however, performed no work for Taxpayer and the reimbursements only "covered" Taxpayer's payroll expenses—including benefits. From these facts, the Department concludes that Taxpayer did not receive a "beneficial interest" in this income. Rather, Taxpayer received the reimbursements in its capacity as agent. The income represented by the reimbursements should not have been included in Taxpayer's Indiana gross income.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

28950681.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 95-0681 CSET
Controlled Substance Excise Tax
For Tax Periods: 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

1. Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-5; IC 6-8.1-5-1(b); Hurst v. Department of Revenue, 720 N.E.2d 370, 374 (Ind. Tax 1999)

Taxpayer protests the assessment of Controlled Substance Excise Tax.

STATEMENT OF FACTS

Taxpayer was arrested for possession of marijuana. The Indiana Department of Revenue issued a record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on September 28, 1995 in a base tax amount of $366,260.00. Taxpayer filed a protest to the assessment. A hearing on the protest was scheduled for March 16, 2000. Taxpayer was notified of the hearing. Taxpayer called the hearing officer and left a message stating that he did not have enough money to pay the tax. Taxpayer did not appear for the hearing. A Letter of Findings denying Taxpayer's protest was issued on March 31, 2000. Taxpayer, through his attorney, requested a rehearing. The rehearing was granted. The attorney submitted documentation in lieu of a hearing. Further facts will be provided as necessary.

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of marijuana in the State of Indiana. Taxpayer bears the burden of proving that the assessment of tax is incorrect. IC 6-8.1-5-1(b). Possession of the marijuana can be either actual or constructive. Hurst v. Department of Revenue, 720 N.E.2d 370, 374 (Ind. Tax 1999). Although both direct and circumstantial evidence may prove constructive possession, proof of presence in the vicinity of drugs, presence on property where drugs are located, or mere association with the possessor is not sufficient. Id., 374-375. To prove constructive possession there must be a showing that Taxpayer had not only the requisite intent but also the capability to maintain dominion and control over the substance. Id., 374.

Taxpayer sold drugs to another party. At one drug sale, Taxpayer asked that party if he would accept a package from Taxpayer's aunt for a payment of $50.00. The other party agreed. Taxpayer called the other party to arrange the time the package would be delivered. Taxpayer was present when the package was first scheduled to be delivered. When the package was not delivered as scheduled, Taxpayer dealt with the UPS office to determine why the package had not arrived and determine when it would be delivered. Taxpayer arrived at the other party's house for the delivery of the package. After delivery of the package, Taxpayer carried the package into the kitchen, opened it and took out the marijuana. At that time Taxpayer told the other party that this was what he had been waiting for.

Taxpayer's actions indicate that he intended to receive and possess the marijuana. He also had the capability to maintain dominion and control over the marijuana. He made arrangements for the delivery of the marijuana, controlled the acceptance of the marijuana, carried it to the kitchen, unwrapped it and took out the drugs. He made a statement indicting his intent to maintain dominion and control over the marijuana.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04970542.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0542 ST
Sales/Use Tax – Cleaning Supplies
Sales/Use Tax – Software Licensing Agreements
For Tax Periods: 1994 through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax – Cleaning Supplies

Authority: IC 6-8.1-3-1; IC 6-8.1-5-1 *et seq.*

Taxpayer protests proposed assessments of Indiana use tax on its purchase of cleaning supplies and materials.

II. Sales/Use Tax – Software Licensing Agreements

Authority: IC 6-2.5-2-1; IC 6-2.5-4-1; IC 6-2.5-4-10; 45 IAC 2.2-4-2; 45 IAC 2.2-5-8(j) *Sales Tax Information Bulletin #8*

Taxpayer protests proposed assessments of Indiana use tax on its acquisition of computer software.

STATEMENT OF FACTS

Taxpayer, a retail merchant and commercial printer, produces and sells marketing materials, envelopes, cards, and other types of printed materials. Taxpayer also prints product labels for manufacturers and produces imprinted cartons for use as packaging.

In conducting its business as a commercial printer, taxpayer purchased cleaning supplies and computer software. Taxpayer neither paid sales tax nor self-assessed use tax on these purchases. Audit, in response, proposed additional assessments of use tax. Taxpayer's subsequent protest resulted in the issuance, by the Department, of a letter of findings ("LOF"). The Department partially sustained taxpayer's protest with regard to the cleaning supplies. But the Department upheld the proposed assessments of use tax on taxpayer's software acquisition.

Taxpayer protests these initial findings. A request for rehearing was timely requested, and granted.

I. Sales/Use Tax — Cleaning Supplies

DISCUSSION

Taxpayer, a commercial printer engaged in manufacturing activities (see IC 6-2.5-5-3(a)(2)), protested Audit's assessment of use tax on purchases of cleaning supplies and materials.

In partially sustaining taxpayer's protest, the Department observed:

> Taxpayer has introduced evidence illustrating the diverse contexts in which the cleaning supplies are used. Taxpayer performs its cleaning activities at three times - during a particular job, between jobs, and at the end of the workday. The Department agrees with Audit's conclusion that cleaning performed between jobs and cleaning done at the end of the workday constitute routine maintenance activities. However, in the context of commercial printing, when taxpayer is required to engage in cleaning activities in order to finish a particular print job, such activities become essential and integral to taxpayer's production process.

And then concluded:

> Since the Department finds that cleaning performed during a particular job or production run is essential and integral to taxpayer's production process, materials used during those activities qualify for exemption under IC 6-2.5-5-3(b) and IC 6-2.5-5-5.1(b). However, when cleaning activities are performed between jobs, between production runs, or at the end of the workday, such use represents post-production maintenance activities. The materials used and consumed in those activities do not qualify for the industrial exemptions - consistent with the language of 45 IAC 2.2-5-8(h) and 45 IAC 2.2-5-12(f).

With regard to the "cleaning" supplies found to be used in production activities, taxpayer's primary concern focuses on the methodology that will be used by the Department to differentiate—pursuant to the initial LOF—taxpayer's non-exempt cleaning activities from its exempt production activities. Taxpayer, in its *Notice of Request for Re-Hearing*, explained:

> [E]ven under the Department's more restrictive view requiring the cleaning to be performed during a particular job, the taxpayer requests a re-hearing for purposes of determining what are qualifying cleaning supplies and [what supplies] are not. Taxpayer has prepared a sampling of weeks during the relevant time period for use as a statistical model and requests the Department's consent to this procedure....

Taxpayer's concerns are premature. Since taxpayer's initial protest was partially sustained, the Department (Audit Division) must revisit the "cleaning supplies" issue. To that end, Audit will conduct a supplemental audit in order to implement the conclusions reached in the initial LOF.

FINDING

Taxpayer's protest is denied.

II. Sales/Use Tax — Software Licensing Agreements

DISCUSSION

Taxpayer protested the assessment of use tax on its acquisition of computer software. Taxpayer presented three arguments. First, taxpayer argued that licensing of software could not be taxed because such transactions did not meet the definition of selling at retail. Second, taxpayer asserted that the opinion in *Lincoln National Life Insurance Company v. Department of State Revenue*, Ind. Cir. Ct., Noble County Docket No. C-80-635 (October 20, 1981), (holding computer software is not tangible personal property), served as controlling authority. The Department rejected both arguments.

Taxpayer also contended its software could not be taxed because the licensing represented use of exempt "customized" software, not nonexempt "canned" software. Taxpayer's argument was summarized in the initial LOF.

> Taxpayer contends that its software meets the definition of custom software because the software is (1) industry specific, (2) sold to only a small number of users (less than 200), (3) purchased as the result of extensive negotiations, and (4) not purchased "off-the-shelf." Additionally, the software required modification to accommodate taxpayer's particular needs. Taxpayer stresses that its software is neither similar nor analogous to taxable "canned" programs which generally are purchased off-the-shelf in shrink-wrapped packages.

In sustaining these proposed assessments, the Department stated:

> The Department recognizes this software agreement entitles taxpayer to use industry specific software - software, taxpayer contends, which has been tailored to meet its specific needs. However, software can be tailored in many ways - ranging from the selection of setup, installation, and configuration options to actual modifications of source code.
>
> It is axiomatic that industry specific software is not re-engineered for each individual licensee. At a minimum, there exists some

quantum of source code that resides, initially, in every copy of vendor's licensed software. This "core programming" is the equivalent of canned software, and is taxable.

However, the sale of custom software is not subject to tax in Indiana. Custom software represents a professional service rendered pursuant to 45 IAC 2.2-4-2. (Also see *Sales Tax Information Bulletin #8*). Modifications and additions to the original source code - changes made specifically for this taxpayer - represent custom programming services; and as such, are not taxable.

Consistent with the aforementioned analysis, the Department concluded that "[*t]o the extent... taxpayer's software acquisition represents the purchase of canned software, taxpayer's protest is denied. To the extent that the price of the software license represents coding modifications required to customize software to meet taxpayer's specific requirements, taxpayer's protest is sustained.*"

In response to the conditional denial of its initial protest, taxpayer has provided additional information and argument to buttress its contention that the acquired software license was for "customized" and not "canned" software.

Taxpayer forwarded to the Department a statement (letter dated June 15, 1999) from its software ("Vendor") regarding the customization required to implement the software. Vendor explains:

> [Vendor's] computer software is a customized software program, which allows the [Vendor] to custom assemble the software to fit the unique situation of each customer. We deliver the software to the customer as an empty shell. As the customer is trained during the implementation process, all of the tables, etc., must be customized by the customer [i.e., taxpayer] to fit their unique business needs.... [Vendor's] computer software can not be installed and put to use like "canned" software. [Vendor] requires many months of training customization prior to being fully implemented in order to educate the customer and to customize the system to meet that customer's requirements.

Taxpayer also submitted additional information in the form of a letter (dated August 23, 1999) and affidavit; each comment on the customized nature of Vendor's software. In substance, the correspondence emphasizes the attributes (as perceived by taxpayer) of "customized" software generally, and of Vendor's software specifically. Cost of acquisition, program utility, necessity of modifications, online support requirements, and time and expenses associated with training and implementation serve to distinguish (according to taxpayer) Vendor's exempt "customized" software from nonexempt "canned" software.

Vendor has developed a highly successful industry-specific software application package (120 installations internationally as of 12/3/99). Vendor currently describes its software system as comprising "a real-time, on-line, multi-user system, providing concurrent access to as many as 1000+ simultaneous users on multiple hardware platforms." In other words, Vendor's software is an "enterprise-wide system compris[ed] [of] fully integrated modules...." The software is both flexible and, depending on modules selected, comprehensive.

After consulting with Vendor, taxpayer purchased Vendor's software package (shell plus modules). Subsequent to purchase—but prior to usage—training, installation, migration, customization, and other implementation activities had to be completed. The Department is not suggesting that such post-acquisition service activities have been or should be taxed. Rather, these activities represent, generally, tax-exempt professional services. (See IC 6-2.5-4-1 and 45 IAC 2.2-4-2). But the necessity of such *post-acquisition* service activities does not transform the character of the software acquired.

Taxpayer sells multiple copies of its software package—albeit with different selections (based on its customers' requirements) of application modules. The programming shell and specific application modules are pre-coded. In other words, the shell and modules are not unique. (Hence, the necessity for post-acquisition modifications.) User groups exist. Vendor's customers receive standardized "programming updates" and "fixes." As Vendor explains:

> Enhancements are routinely made availability to existing users via new releases of general improvements and entire new modules. [Vendor] relies heavily on input from the [User Group] to set priorities for desired enhancements and major new modules.

Together, the aforementioned are all indicia of nonexempt "canned" software.

Computer software is taxable—much like books, sound recordings, and video presentations—regardless of medium used for transfer. However, when software is created for and sold to only one customer, the software represents the provision of exempt professional services. In this instance, taxpayer purchased an industry-specific, comprehensive, software package. The software was not "written" exclusively for taxpayer. The necessity of post-acquisition activities may be indicia of the software's complexity and comprehensiveness—but not of its "customized nature."

Because of the software's flexibility, comprehensiveness, and relatively open architecture, the time and resources committed to software implementation—i.e., the steps necessary to get the software "up and running"—were considerable. However, no evidence exists, or has been presented, to suggest these professional services were performed prior to taxpayer acquiring its software or represent pre-acquisition modifications of source code. The "customization" referred to by taxpayer was part of the software implementation process. Additionally, no evidence has been presented to suggest that Audit proposed assessments of use tax on the costs of these professional services. Consequently, the Department must endorse its initial findings.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990385P.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 99-0385P

Gross Income Tax
Calendar Year Ended 12/31/97

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer, a Delaware corporation, protests penalties assessed for calendar year ended December 31, 1997. A rehearing request was approved. Taxpayer provided written documentation dated July 31, 2000.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states it exercised reasonable care, caution, and diligence and provides the following:

1) For at least 10 years, taxpayer had successfully met its tax payment and filing obligations in Indiana and had been in business in Indiana since 1980.
2) Taxpayer and its predecessors have been in good corporate standing with the State of Indiana.
3) The most senior tax employee left in December 1995, leaving taxpayer without tax manager oversight.
4) Through 1996 and 1997, taxpayer hired various consultants to advise it as to, among other matters, its various tax filing requirements in all 50 states.
5) Taxpayer hired and retained experienced tax consultants, accountants, and preparers to assist it in meeting its tax filing obligations.
6) In February of 1998, taxpayer was finally able to employ experienced tax personnel who ensured compliance with Indiana tax compliance requirements, which resulted in the error being discovered by taxpayer.
7) In May/June of 1998, taxpayer's tax personnel discovered the error in underpayment of tax and immediately paid the amount due, even though the Indiana tax return was not filed until September/October of 1998.

Taxpayer states the foregoing points support reasonable care, caution, and diligence being exercised on the part of the taxpayer, but the strongest point is that the taxpayer could not have taken any additional action on its part to avoid the penalty, That is, the Taxpayer made every reasonable attempt to ensure compliance with the tax payment and filing obligations in Indiana. The error (made by the tax preparer) occurred despite the reasonable care, caution, and diligence exercised by the Taxpayer. Clearly, the actions taken by the Taxpayer do not represent actions of "carelessness, thoughtlessness, disregard, or inattention to duties." Accordingly, the Taxpayer respectfully requests that the penalty be waived.

IC 6-8.1-10-2.1 assesses a penalty (a) If a person:

(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.

On September 17, 1999 the department issued its proposed assessment for the tax balance, penalty, and interest. Penalty was calculated at ten percent (10%) for the payment made on June 16, 1998 less credit for payment previously made. The penalty was assessed because the payment was late and less than ninety percent (90%) of the expected tax due was not paid by the original due date. Taxpayer history indicates it made the first two quarter payments of estimated tax on April 18, 1997. No further estimated payments were made. In fact, the check in the amount of $220,000 was not postmarked until July 1, 1998.

IC 6-8.1-6-1 clearly states that at least ninety percent (90%) of the tax that is reasonably expected to be due must be paid on or before the due date or penalties may be imposed for failure to pay the tax.

Taxpayer failed to provide reasonable cause to allow the department to waive its penalty. Taxpayer, as the successor of several S-corporations that operated in the State of Indiana, should have made itself aware of its tax liabilities.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2000-08 IT
October 4, 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax – Application of Gross Income Tax
Authority: 45 IAC 1.1-3-3

Taxpayer requests that the Department rule on its gross income tax liability.

STATEMENT OF FACTS

Taxpayer, a Delaware corporation, is a manufacturer with a plant located in Indiana, where it produces, *inter alia*, Product A. Taxpayer's wholly owned subsidiary is a 50% partner in a partnership that owns and operates a processing plant also located in Indiana ("Partnership").

Partnership was formed to enable Taxpayer to build a more modern processing plant and increase the output of Product B, which is produced from Product A. Currently, Partnership is engaged in the processing of Product A into Product B. Product A is directly shipped to Partnership from Taxpayer's Indiana plant or from a nearby industrial processor that completes the production of Product A for Taxpayer.

Partnership has no sales force of its own and depends completely upon Taxpayer to perform sales, credit, and collection activities for it. All sales of Product B are made pursuant to prior orders submitted to Taxpayer's sales offices. Taxpayer's employees also provide technical services to customers purchasing Product B. Most of the purchasers of Product B are manufacturers and are located outside of Indiana.

Upon receipt of an order for Product B, Taxpayer schedules and coordinates its production. While Taxpayer has the ability at its own plant to process Product A into Product B, Taxpayer is required to give priority to Partnership with respect to orders received for Product B. Therefore, most orders for Product B are filled by Product B produced by Partnership.

When ready, Product B is shipped directly from Partnership's facility to the customer's designated location, pursuant to the prior order submitted to Taxpayer. While a small percentage of those shipments are to in-state (Indiana) locations, most shipments of Product B are to out-of-state destinations and are made by either common or contract carrier.

The contractual arrangement between Taxpayer and Partnership calls for Taxpayer to sell Product A to Partnership so that it can produce Product B. (With respect to one major customer, Taxpayer retains title to Product A and Partnership acts as an industrial processor in processing it into Product B.) However, through a unique pricing mechanism, Taxpayer continues to bear all risk and essentially pay all of the costs associated with Partnership's business, including Partnership's purchase of Product A.

Under the pricing formula which is specified by contract, Taxpayer is ultimately only entitled to a price for Product A based upon the sale price earned by Partnership on Product B, less all the costs and expenses of Partnership and a return to its partners. Specifically, the price owed Taxpayer for Product A is determined by a formula that starts with the price for which Product B is ultimately sold. The formula works backward from that price to assure that the price paid Taxpayer for Product A:

1. Allows Partnership to cover all of its expenses and costs, including its debt obligations. (Once title to Product A is transferred to Partnership, Product A is pledged to pay Partnership's indebtedness), and
2. Provides for a guaranteed return to the partners of Partnership.

Although Partnership actually makes cash payments to Taxpayer for Product A throughout the year, these payments are periodically "trued up" to conform to this formula, with money to be returned to Partnership if the formula does not support the amount already remitted to Taxpayer.

It is significant that if Partnership did not or could not sell Product B, there would be no amounts payable to Taxpayer for Product A and, in fact, Taxpayer would have to make payments to Partnership to cover Partnership's costs, expenses and obligations, as well as the guaranteed return. (Taxpayer confirms that this has happened at least once, meaning that Taxpayer paid Partnership to take Product A.)

Taxpayer has concluded that the demand for Product A is rising and a second Product B processing line is warranted. As currently contemplated, this new investment will be owned and operated by a new entity, most likely a partnership or limited liability company, but the manner in which Product A and Product B are sold, including the pricing mechanism, will be the same as the current arrangement between Taxpayer and Partnership described above.

Taxpayer requests confirmation that its sales of Product A to Partnership and to the new entity to be formed to own and operate the second line will not be subject to Indiana gross income tax.

DISCUSSION

A nonresident taxpayer is only subject to gross income tax on income derived from Indiana sources. IC 6-2.1-2-2(a)(2). Income from sales of personal property is nontaxable when the sale is made upon receipt of a prior order and, by the terms of the sales agreement, the goods are required to be shipped and are shipped from a point in Indiana to a purchaser at a destination outside of Indiana. J. D. Adams Manufacturing Company v. Storen (1937), 212 Ind. 343, 7 N.E. 2d 941. The taxability of receipts for gross income tax purposes is determined by looking at the source of those receipts. In determining the tax treatment of a transaction, its substance controls over its form. Meridian Mortgage Company v. State (1979) 395 N.E. 2d 443.

Based on the facts recited herein, the Department finds that Taxpayer's income from the sale of Product A to Partnership is not subject to gross income tax to the extent that it (Product A) is thereafter processed into Product B and then shipped in interstate commerce to customers outside of Indiana. It is significant that in this case there is a prior order for the purchase of Product B, which Taxpayer and Partnership work together to fill, with Taxpayer's employees providing technical and administrative services necessary to effectuate the sale and eventual shipment of Product B in interstate commerce by common or contract carrier. It is also important to this finding that Taxpayer bears the risk of the production of Product B and, through the pricing mechanism, guarantees all of the costs incurred in such production. Finally, it is significant that the price that Taxpayer ultimately earns for Product A is determined by and dependent upon the actual sales price of Product B.

In short, the Department finds that Taxpayer's receipts from the sale of Product A to Partnership is actually derived from the sale of Product B, which, in the case of sales to out-of-state customers, is nontaxable. Therefore, Taxpayer's gross receipts from the sale of Product A to Partnership shall be subject to gross income tax only to the extent that Product A is processed into Product B and ultimately delivered to Indiana destinations. To the extent that Product A is processed into Product B and sold in interstate commerce to out-of-state customers, Taxpayer's sales of Product A to Partnership shall not be subject to gross income tax. The Department also confirms that the percent of Taxpayer's Product A sales that are subject to gross income tax may be determined by applying the percentage of intrastate shipments of Product B to Taxpayer's Product A sales to Partnership.

The Department also rules that, provided Taxpayer's arrangements with the new entity formed to own and operate the second line are the same as its arrangements with Partnership, the gross income tax treatment of its sales of Product A shall be the same, *i.e.*, there shall be no gross income tax due on Taxpayer's sales of Product A to the new entity to the extent that the new entity processes Product A into Product B and ships Product B to out-of-state destinations.

RULING

Since there is a prior order for a shipment of goods in interstate commerce that is not considered filled until shipment of the Product B by Partnership, the Department rules that Taxpayer's sales of Product A to Partnership and to the new entity to be formed for the second production line does not give Taxpayer gross receipts subject to gross income tax to the extent Product A is processed into Product B by Partnership and shipped to out-of-state destinations.

CAVEAT

This ruling is issued to the taxpayer, requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of taxpayer is different in any material respect, from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, regulation or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2000-08 ST
September 29, 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

Sales/use Tax – Application of Sales/Use Tax for a Contractor Who Purchases Goods for Exempt and Non-exempt jobs
Authority: 45 IAC 2.2-3-8(b); 45 IAC 2.2-3-12(a)&(b); IC 6-2.5-8-1; IC 6-2.5-8-8

The taxpayer requests the Department to rule on the taxability of purchases in large quantities for use in exempt and non-exempt jobs.

STATEMENT OF FACTS

The taxpayer is an Indiana construction company and a highway contractor where approximately 80% of its work is for either the Indiana Department of Transportation or other state or local government agencies. The taxpayer pays sales tax on all its "Bridge Division" inventory, which is primarily truckload quantities of steel piling ultimately incorporated into the construction of tax-exempt projects. However, a small quantity, approximately 20%, is used for other taxable jobs.

The taxpayer requests Departmental review of the application of sales/use tax to the purchases of the truckload quantities of steel piling. Specifically, the taxpayer requests a ruling on whether or not the purchases can be acquired exempt from sales tax where the taxpayer will pay use tax when the inventory is eventually incorporated into taxable jobs.

DISCUSSION

45 IAC 2.2-3-8(b) states:

> All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

In this case, the steel pilings, which are fungible, and therefore impossible to determine exempt from non-exempt, are purchased by the taxpayer subject to sales/use tax at either the time of purchase or when they are incorporated into a project for an entity subject to sales/use tax. The purchases are not subject to sales/use tax when they are incorporated into a project for an entity that is not subject to sales/use tax; in this case, a government agency.

45 IAC 2.2-3-12(a)&(b) state:

a) Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.

b) In order to be exempt on such purchases, the contractor must be registered as a retail merchant, must obtain an exemption certificate from the exempt organization, and must issue an exemption certificate to his supplier.

Again, the steel pilings are exempt from sales/use tax when incorporated into a project for an entity that is exempt. In order for the purchases to be exempt, the taxpayer must be a registered retail merchant pursuant to IC 6-2.5-8-1. Additionally, the taxpayer must obtain a form ST-105 from the entity that it is performing the service for and provide an ST-134 to the supplier of the steel pilings.

The form ST-105 is a general exemption certificate for the state of Indiana and is required to be supplied by a purchaser to a seller in exempt transactions pursuant to IC 6-2.5-8-8. An ST-134 is a similar exemption form used by contractors in exempt purchases.

RULING

The Department rules that the taxpayer may purchase the steel pilings without paying sales tax, so long as it pays use tax on the steel pilings when they are incorporated into a taxable project.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.