

STATE OF MAINE
KENNEBEC, ss

MAINE BOARD OF TAX APPEALS
DOCKET NO. BTA-2012-1

INDIVIDUAL TAXPAYER,
CORPORATE TAXPAYER A, and
CORPORATE TAXPAYER B,

Petitioners

v.

DECISION

MAINE REVENUE SERVICES,
Respondent

I. Background

Individual Taxpayer, Corporate Taxpayer A (“Corporation A”), and Corporate Taxpayer B (“Corporation B”) appeal from assessments of Maine use tax on certain [equipment B] and on fuel. These assessments resulted from audits of Individual Taxpayer for [audit period 1], of Corporation A [for audit period 2], and of Corporation B for [audit period 3]. Pursuant to their requests, their appeals have been consolidated for hearing and decision. The issues on appeal are (1) whether certain [equipment B is] exempt from use tax pursuant to 36 M.R.S. § 1760(31), based on being used by the purchaser directly and primarily in the production of tangible personal property for sale; (2) whether 95% of the sale price of fuel used by certain [] equipment is exempt from use tax pursuant to 36 M.R.S. § 1760(9-D) because it was used at a manufacturing facility; and (3) whether penalties should be abated.

An Appeals Conference was held telephonically []. Conference participants included: [Representative] for Petitioners, [Representatives] for Respondent Maine Revenue Services (“MRS”), and [], Appeals Officer.

II. Facts

Individual Taxpayer has been in [] business in Maine as a sole proprietor []. In [year 1], he incorporated Corporation A [] to engage in [] business and in [year 2] he incorporated Corporation B [] for the same purpose. He is the sole shareholder and President of both Corporation A and Corporation B.

According to MRS, [Landowner] contracted with Corporation A to fabricate [tangible personal property] for sale to [Landowner's Customers]. In order to fulfill that contract, Corporation A was loaned employees by Corporation B and it apparently leased machinery and equipment from Individual Taxpayer. Individual Taxpayer personally worked in the [operation] and supervised both Corporation B's and Corporation A's crews. Corporation A used [equipment A] to [obtain the raw material], [equipment B] to haul the [raw material] to [the location] where [equipment C modified the raw material], [equipment D] loaded [the raw material] into [equipment E], and [equipment E] fabricated the [tangible personal property]. Corporation A moved [equipment D and E] from place to place on [Landowner's] land so that the [production] could be done as close as feasible to the [location where equipment A obtained the raw material]. The number of pieces of [] equipment used by Corporation A in its [production] operation varied during the audit periods.

MRS conducted sales and use tax audits of Individual Taxpayer, Corporation A, and Corporation B beginning in late [year 3]. Individual Taxpayer's audit resulted in an assessment of use tax on [equipment B] and on other [equipment and machinery], together with failure-to-file and substantial understatement penalties. The use tax, interest, and penalties assessed totaled \$[amount]. Individual Taxpayer requested reconsideration of the use tax assessed on [equipment

B], arguing [that equipment was] exempt from use tax pursuant to 36 M.R.S. § 1760(31) as [that equipment was] used directly and primarily in production. He also requested abatement of all penalties. On [reconsideration date], MRS issued its reconsideration decision upholding its assessment in full.

In its audit of Corporation A, MRS found that 95% of the purchase price of the off-road fuel used by [equipment D and E] was properly exempted from use tax, but that the purchase price of the off-road fuel used by [equipment A, B, and C] was fully taxable. MRS also assessed: (1) use tax on [other equipment, services, supplies, and materials used in obtaining raw materials]; and (2) penalties for substantial understatement of tax. The use tax, interest, and penalty assessed totaled \$[amount]. Corporation A requested reconsideration of the assessment with respect to the off-road fuel, arguing that all of the fuel it used was exempt pursuant to 36 M.R.S. § 1760(9-D) because it was used at a manufacturing facility, and requested abatement of the penalty. MRS issued its reconsideration decision on [reconsideration date], upholding its assessment in full.

Finally, in its audit of Corporation B, MRS allowed the exemption of 95% of the purchase price of the off-road fuel used by [equipment D and E], but not the fuel used by any other equipment. MRS also assessed: (1) use tax on [other items used to obtain raw materials] and on heating fuel purchased by Corporation B; and (2) penalties for failure-to-file required sales and use tax returns. The use tax, interest, and penalties assessed totaled \$[amount]. Corporation B requested reconsideration of the tax assessed on off-road fuel and abatement of the penalties. MRS issued its reconsideration decision on [reconsideration date], upholding its assessment in full.

III. Law

Use tax is imposed “on the storage, use or other consumption in this State of tangible personal property or a service, the sale of which would be subject to” sales tax. 36 M.R.S. § 1861. However, machinery or equipment purchased “for use by the purchaser directly and primarily in the production of tangible personal property intended to be sold” is exempt from sales and use tax. 36 M.R.S. § 1760(31). “Production” is defined as “an operation or integrated series of operations engaged in as a business . . . that transforms or converts personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed[.]” 36 M.R.S. § 1752(9-B). MRS’ Rule 303 provides that “[p]roduction” . . . commences with the movement of raw materials to the first production machine” 18-125 C.M.R. ch. 303, § 1 (2007). MRS advises, in MRS Instructional Bulletin No. 22 that

[t]he purchaser of the machinery and equipment must also be the *user of machinery and equipment in the production process* in order to qualify for the exemption. *Lessors* of machinery and equipment under a true lease are not entitled to an exemption even though the lessee is using the machinery and equipment in production.

Sales, Fuel & Special Tax Division, Instructional Bulletin No. 22, § II, sub-§ A, ¶ 2 (October 15, 2000). Individual Taxpayer argues that [equipment B was] used in production as [that equipment] moved [raw materials to] the first production machine. On audit, MRS determined, however, that Individual Taxpayer used [equipment B] to generate rental income, and not for production of tangible personal property.

Maine law exempts “[n]inety-five percent of the sale price of all fuel . . . purchased for use at a manufacturing facility” from sales and use tax. 36 M.R.S. § 1760(9-D). A “manufacturing facility” is defined as “a site at which are located machinery and equipment used

directly and primarily in . . . the production of tangible personal property intended to be sold . . . for final use or consumption It includes the machinery and equipment and all machinery, equipment, structures and facilities located at the site and used in support of production or associated with the production.” 36 M.R.S. § 1752(6-A). Corporation A and Corporation B argue that all the off-road fuel they purchased was exempt as it was all used at a manufacturing facility.

IV. Analysis

A. [Equipment B]

Individual Taxpayer asserts that the two [items of equipment B] are exempt from use tax under section 1760(31), which exempts from taxation the sale of machinery and equipment “for use by the purchaser directly and primarily in the production of tangible personal property intended to be sold” The Law Court has construed the phrase “for use by the purchaser” to mean that the exemption was not “intended to be available if the ‘use’ . . . was by someone other than the purchaser.” *Harold MacQuinn, Inc. v. Halperin*, 415 A2d. 818, 821 (Me. 1980). Therefore, Section 1760(31) has two requirements that must be met in order for machinery and equipment to be exempt. First, it must be used by the purchaser, and second, such use must be directly and primarily in the production of property for sale. Because the first requirement, whether [equipment B was] used by the purchaser, is dispositive of the question of whether [that equipment is] exempt from use tax, the Board does not need to determine whether the second requirement was met.

Individual Taxpayer makes three arguments to support his claim that [equipment B was] used directly and primarily in production by the purchaser. First, he argues that [equipment B was] purchased by Corporation A and not by him personally. Second, he argues that if [equipment B was] purchased in his name, it was in error as he was acting as Corporation A’s

agent in purchasing [that equipment]. Finally, he argues that Corporation A's and Corporation B's corporate existence should be disregarded, as he is sole shareholder and president of each corporation, neither corporation acts other than through him, and he worked each day [on location] supervising both companies' employees.

In support of his first two arguments, Individual Taxpayer submitted copies of invoices stating [equipment B was] sold to "Individual Taxpayer d/b/a Corporation A." These invoices, however, indicate that [equipment B was] sold to Individual Taxpayer individually, and not to Corporation A. This is because, as many courts have explained:

The designation of 'DBA' or 'doing business as' simply indicates [that the first person named] operates under a fictitious business name. . . . Use of a fictitious business name does not create a separate legal entity."

Pinkerton's Inc. v. Superior Court, 49 Cal. App. 4th 1342, 1348, 57 Cal. Rptr. 2d 356 (1996).

See also Southern Ins. Co. v. Consumer Ins. Agency, Inc., 442 F. Supp. 30 (E.D. La. 1977),

Wood Mfg. Co. v. Schultz, 613 F. Supp. 878 (W.D. Ark. 1985), and *Jaffe v. Nocera*, 493 A.2d 1003 (D.C. Ct. App. 1985).

Thus, when Individual Taxpayer used the "d/b/a" designation in purchasing [equipment B], his use of that designation did not change the fact that he was the person conducting the transaction. There was no other separate legal entity involved. If anything, Individual Taxpayer's use of the "d/b/a/" designation indicated that he may have been disregarding the separate legal existence of Corporation A, and treating it as merely a fictitious business name under which he did business as an individual. As explained below, however, such treatment of Corporation A is inappropriate.

In response to Individual Taxpayer's argument that he was acting as Corporation A's agent in purchasing [equipment B], MRS points to its auditor's report stating that Individual

Taxpayer, as sole proprietor, reported rental income from [equipment B] and claimed depreciation deductions for each of them []. This report was based on a review of all of Individual Taxpayer's relevant business records and federal income tax returns. When asked at the conference, Individual Taxpayer's representative did not dispute the auditor's assertion. Following the conference, the Appeals Officer requested that Individual Taxpayer submit relevant copies of his individual income tax returns. The submitted returns were not inconsistent with the auditor's conclusions. [].

By apparently claiming a depreciation deduction on [equipment B], and charging and receiving rental payments for their use from his corporations, Individual Taxpayer seems to have deliberately treated [equipment B] as his individual property, and not as property of Corporation A. Such treatment contradicts his contention that [equipment B was] owned by Corporation A or that he acted as Corporation A's agent when he purchased them. The preponderance of the evidence supports the finding that Individual Taxpayer owned [equipment B] in his individual capacity.

Finally, in response to Individual Taxpayer's third argument, that the corporations should be disregarded and all of the property and operations at issue here should be attributed to Individual Taxpayer, MRS notes that Maine law has long been that the separate existence of corporations will not lightly be disregarded. The Law Court has held, with respect to tax issues, that "[w]hen independent corporations are created in order to achieve some benefits, they must accept any accompanying detriments." *Linnehan Leasing v. State Tax Assessor*, 2006 ME 33, ¶ 20, 898 A.2d 408 (citing *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 439, 63 S. Ct. 1132, 87 L.Ed.1499 (1943)). Individual Taxpayer, for what we must assume to have been legitimate business reasons, chose to create both Corporation A and Corporation B. Having

obtained the benefits of his chosen course of action, Individual Taxpayer must accept the accompanying detriments, one of which is that he may not disregard their existence when doing so might be advantageous for tax purposes.

B. Off-Road Fuel

Both Corporation A and Corporation B argue that all the off-road fuel they purchased during the audit period was used at a “manufacturing facility” and thus qualified for exemption pursuant to 36 M.R.S. § 1760(9-D). They point out that the definition of “manufacturing facility” found in 36 M.R.S. § 1752(6-A) is very broad and “*includes . . . all machinery, equipment, structures and facilities located at the site and used in support of production or associated with the production.*” 36 M.R.S. § 1752(6-A) (emphasis added). They argue that [equipment A, B, and C] were used in support of [] production and were used in such close proximity to [equipment D and E] that all their machinery and equipment was located at a single site.

MRS argues that its assessment should be upheld in full because the site at which [equipment A obtained the raw materials and from which equipment B moved the raw materials] was separate and distinct from the site at which the [production] operations took place. As a result, the machinery and equipment used in [obtaining the raw materials and moving them to the place where equipment C, D, and E were located], although supportive of and associated with the production were not “located at the [manufacturing facility] site,” as required for exemption.

Following the appeals conference, the Appeals Officer concluded that based upon the facts of this case, all of Corporation A’s and Corporation B’s machinery and equipment was used at a single manufacturing facility and recommended that the Board cancel the assessment of use tax on fuel in full.

At the Board hearing on the Appeals Officer's recommended decision, MRS stated that under the particular facts and circumstances of this case, it did not contest the Appeals Officer's recommended decision with respect to the fuel. The Board, given MRS' decision not to contest the Appeals Officer's recommended decision, hereby cancels the use tax assessed on the off-road fuel in full.

C. Penalties

Pursuant to 36 M.R.S. § 187-B(7), "[t]he assessor shall waive or abate . . . any penalty . . . if grounds constituting reasonable cause are established by the taxpayer" Reasonable cause includes when "[t]he taxpayer has supplied substantial authority justifying the failure to file or pay" Individual Taxpayer, Corporation A, and Corporation B all argue that reasonable cause exists to waive or abate the penalties assessed against them because they have substantial authority supporting their assertions that [equipment B] and the off-road fuel was exempt. They additionally argue that the complexity and nuances involved in interpreting the sales tax law and the precariousness of their financial situation also constitute reasonable cause to abate penalties.

Failure-to-file penalties were assessed against both Individual Taxpayer and Corporation B. Section 187-B(1)(A) imposes a penalty equal to 10% of the tax due on any "person who fails to make and file any return required under [Title 36] at or before the time the return becomes due" Individual Taxpayer has not shown reasonable cause to abate the failure-to-file penalty against him because the requirement that it is the purchaser, not a lessee, that uses machinery and equipment directly and primarily in production has been clear since the *MacQuinn* decision in 1980 and has been explicitly stated in MRS Instructional Bulletin No. 22 since at least October 15, 2000. This Bulletin No. 22 is available to the public on MRS' web site. Our cancellation of

the assessment of use tax on Corporation B's purchase of off-road fuel necessarily cancels the amount of the failure-to-file penalty attributable to the purchase of off-road fuel.

Substantial understatement penalties were imposed upon both Individual Taxpayer and Corporation A. The law imposes a penalty equal to 25% of any underpayment of tax on any "person who files a return under [Title 36] that results in an underpayment of tax, any portion of which is attributable to a substantial understatement of tax, without negligence or intentional disregard of [Title 36] or rules adopted pursuant to [Title 36] and without fraud with intent to evade the tax" 36 M.R.S. § 187-B(4-A). Individual Taxpayer has not shown reasonable cause exists to abate the substantial understatement penalty imposed on him. No substantial authority supported his contention that [equipment B was] exempt under section 1760(31) for the same reason explained above with respect to the failure-to-file penalty. In addition, the case law requiring the recognition of corporations as separate legal entities weighs against the existence of any substantial authority for Individual Taxpayer's argument that his actions should be attributed to his corporations. Individual Taxpayer has furthermore not shown reasonable cause to abate the substantial understatement penalty due to the complexity of sales tax law, nor due to his financial situation. The requirement that the purchaser, not some other person, use the machinery and equipment directly and primarily in production has been clearly stated in Bulletin No. 22 and is not a complex requirement. Regarding Individual Taxpayer's comments concerning his financial situation, he has not demonstrated an inability to pay the liabilities discussed herein. He may, however, wish to discuss his situation with MRS to either reach a settlement concerning collection or obtain a payment plan that would allow him to pay these liabilities over time.

Because we have cancelled the use tax assessment on off-road fuel, the substantial understatement penalty assessed against Corporation A is cancelled to the extent the imposition, or amount, of the substantial understatement penalty is due to use tax on off-road fuel.

V. Decision

The use tax assessed on Individual Taxpayer's [equipment B] is upheld in full, as they were not used in the production of property for sale by the purchaser. The penalties assessed against Individual Taxpayer are also upheld in full as he has not shown reasonable cause for their waiver or abatement.

The use tax assessed on off-road fuel purchased by Corporation A and Corporation B is cancelled in full. Finally, the penalties assessed against Corporation A and Corporation B are abated to the extent the amounts of those penalties derive from their purchase of off-road fuel.

If no motion for reconsideration is filed within 20 days of the date of this proposed decision, it will become the Board's final administrative decision on the appeal. If you wish to appeal this decision to the Superior Court, you must do so within 60 days from the date it becomes the Board's final administrative decision on the appeal.

SO ORDERED.

Issued by the Board: March 14, 2013