STATE OF MAINE
KENNEBEC, ss.

MAINE BOARD OF TAX APPEALS
DOCKET NO. BTA-2015-17

[CORPORATE TAXPAYER],

Petitioner

v.

MAINE REVENUE SERVICES,

Respondent

DECISION

[Corporate Taxpayer] (the "Company"), a Maine corporation engaged in the business of wood harvesting, appeals from an assessment of use tax, interest, and penalties issued against it by Maine Revenue Services ("MRS") for the period [Year 5] through [Year 8] following an audit of the Company's books and records. The portion of the assessment challenged by the Company relates to [a number of] pieces of machinery (the "Harvesters") that it purchased during the audit period without paying sales tax, and upon which MRS determined use tax was therefore owed pursuant to 36 M.R.S. §1861. Based on the law and the circumstances presented, we cancel the penalties contained in the assessment and uphold the remainder of the assessment in full.

I. Background

This is not the Company's first experience with MRS's audit and assessment process. On [date], MRS issued an assessment against the Company following an audit of the Company's books and records for the period [Year 1] through [Year 4]. As a result of that audit, MRS determined that the Company was liable for use tax, interest, and penalties based on its purchases of several items of machinery and equipment without paying sales tax. Prior to issuing the

assessment, however, the MRS auditors removed four items of special mobile equipment[1] from their initial findings—two cranes and two excavators—because the machinery was being used by the Company directly and primarily in the production for sale of woodchip biofuel and was therefore sales tax-exempt.[2] The auditors also removed a lumber harvesting vehicle—a feller-buncher—because the Company had purchased the machine at casual sale,[3] and removed another lumber harvesting vehicle—a skidder—because the Company had purchased it at "a trade-even at a dealer."[4]

The present appeal concerns an assessment issued against the Company by MRS on [date], following an audit of the Company's books and records for the period [Year 5] through [Year 8]. As a result of this audit, MRS determined that the Company was again liable for use tax, interest, and penalties on, among other items, the Company's purchases of special mobile equipment—[certain tree harvester machines purchased between the end of Year 5 and the beginning of Year 6] (the "Harvesters")—without paying sales tax. After purchase, the

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[1] "Special mobile equipment" is defined as "any self-propelled vehicle not designed or used primarily for the transportation of persons or property that may be operated or moved only incidentally over the highways, including, but not limited to road construction or maintenance machinery, farm tractors, lumber harvesting vehicles or loaders, ditch-digging apparatus, stone crushers, air compressors, power shovels, cranes, graders, rollers, well drillers and wood sawing equipment."). 36 M.R.S. § 1752(14-B).

[2] Pursuant to 36 M.R.S. § 1760(31)(A), "no tax on sales, storage or use may be collected upon or in connection with . . . [s]ales of machinery and equipment . . . [f]or use by the purchaser directly and primarily in the production of tangible personal property intended to be sold or leased ultimately for final use or consumption . . . ."

[3] A "casual sale" is "an isolated transaction in which tangible personal property or a taxable service is sold other than in the ordinary course of repeated and successive transactions of like character by the person making the sale." 36 M.R.S. § 1752 (1-D). With certain exceptions, casual sales of tangible personal property are not subject to sales or use tax. 36 M.R.S. §§ 1811, 1752(11)(B)(1), 1764. Pursuant to section 1752(14-B), a feller-buncher is classified as "special mobile equipment," which is generally subject to use tax at casual sale. *Id.* § 1764. However, section 1764 specifically provides that "[f]or purposes of this section [imposing use tax at casual sale], 'special mobile equipment' does not include farm tractors *and lumber harvesting vehicles or loaders*." (Emphasis added).

[4] Pursuant to 36 M.R.S. § 1765, when an item of special mobile equipment such as a skidder is "traded in toward the sale price of another item in that same category, sales tax is levied only upon the difference between the sale price of the purchased property and the trade-in allowance of the property taken in trade." In the case of an even trade, the difference subject to tax would be zero.

Company used the Harvesters to sever trees from the earth for use in producing woodchip biomass fuel. The Company timely requested that MRS reconsider the penalty portion of the assessment in the amount of $[amount]; however, MRS upheld the assessment in full on [date]. The Company then filed its timely appeal with the Board, requesting to be relieved of the aforesaid penalties as well as the assessed interest in the amount of $[amount]. Additionally, prior to the appeals conference, the Company submitted a written argument wherein it requested that the Board also cancel the assessed tax of $[amount], in addition to the interest and penalties, for a total of $[amount].

The issues raised by the Company on appeal are (1) whether use tax was incorrectly assessed on the Company's purchases of the Harvesters, and (2) if the tax were correctly assessed, whether the interest and penalties contained in the assessment should otherwise be abated. It is the Company's burden to show that it is more likely than not that the tax, interest, or penalties contained in the assessment should be abated. 36 M.R.S. § 151-D(10)(F).

MRS also argues that the Board does not have the authority to consider the Company's challenges to the assessed tax and interest, whereas the Company did not raise those portions of the assessment in its request for MRS reconsideration under 36 M.R.S. § 151.

II. Discussion

1. Jurisdiction of the Board of Tax Appeals

As a threshold matter, MRS contends that the Board's scope of review on appeal is limited to the issues raised or addressed in the reconsidered decision issued to the Company by MRS. Specifically, MRS argues that because the Company did not ask MRS to reconsider the tax and interest portions of the assessment, the Board is without authority to consider anything beyond the assessed penalties that MRS reconsidered. MRS reasons that the "doctrine of

exhaustion of administrative remedies" and its corollary, "the failure to preserve" rule, require a party to first present its arguments and claims to the agency so that the agency has the opportunity to make a determination prior to appeal. *See New Eng. Whitewater Center, Inc. v. Dep't of Inland Fisheries & Wildlife*, 550 A.2d 56, 58-59 (Me. 1988) ("Generally, plaintiffs in a Rule 80C proceeding for review of final agency action are expected to raise any objections they have before the agency in order to preserve these issues for appeal. Issues not raised at the administrative level are deemed unpreserved for appellate review."). As stated in *New Eng. Whitewater*,

> the rule requiring that an issue be raised before the administrative agency in order for it to be preserved on appeal is not specifically based on a need for factfinding. Rather, it is based on "simple fairness to those who are engaged in the tasks of administration, and to litigants," and ensures that the agency and not the courts has the first opportunity to pass upon the claims of the litigants.

Id. at 60 (citations omitted). As we explain below, we disagree that the scope of our review is limited as suggested by MRS.

The jurisdiction of the Board is governed by 36 M.R.S. § 151. A person subject to and aggrieved by an assessment or determination by MRS may request that MRS reconsider that assessment or determination. *Id.* § 151(1). Where a request for reconsideration does not involve an amount in controversy of less than $1,000, MRS's decision on reconsideration is "subject to review either by the [B]oard or directly by the Superior Court." *Id.* § 151(2)(E). If the jurisdictional dollar amount is satisfied and all timeliness requirements are met,[5] "the board or Superior Court shall conduct a de novo hearing *and make a de novo determination of the merits of the case*." *Id.* § 151(2)(G) (emphasis added). Prior to the 1991 revision of 36 M.R.S. § 151

[5] A person subject to an assessment by MRS must request reconsideration, if at all, within 60 days after receipt of notice of the assessment. 36 M.R.S. § 151(1). A person who wishes to appeal an MRS-reconsidered decision to the Maine Board of Tax Appeals or to the Superior Court must do so within 60 days after receipt of the reconsidered decision. *Id.* § 151(2)(F).

(effective June 30, 1992), MRS's reconsideration decisions were reviewed "by the Superior Court in accordance with the Maine Administrative Procedure Act, except that the absence of a record shall be resolved exclusively by a hearing de novo on review." *Jackson Adver. Corp. v. State Tax Assessor*, 551 A.2d 1365, n.1 (Me. 1988). In construing the pre-revision version of section 151, the Law Court stated that

> [a]lthough 36 M.R.S.A. § 151 permits a *de novo* hearing for the purpose of providing a substituted record for judicial review, a *de novo* determination, such as that undertaken by the judge in this case, is not authorized. Even with a *de novo* hearing under section 151, judicial review is confined to a "complete review of questions of law and to limited review of questions of fact only to test the reasonableness of the conclusions reached."

Jackson Adver. Corp. at 1366 (citing *Frank v. Assessors of Skowhegan*, 329 A.2d 167, 170 (Me. 1974)). The legislature's 1991 revision of section 151, however, added the requirement that "[t]he Superior Court shall conduct a de novo hearing *and make a de novo determination of the merits of the case*." *Serv. & Erection Co. v. State Tax Assessor*, 684 A.2d 1, 2 (Me. 1996) (citing P.L. 1991, ch. 873, § 3) (emphasis added). This new language is the same language now applicable to the Board under current section 151(2)(G). The Law Court has also construed the effect of the new statutory language of section 151:

> Because 36 M.R.S.A. § 151 expressly requires that the Superior Court conduct a "de novo hearing and make a de novo determination" of the merits of the case, we reason[ ] that the Superior Court "no longer functions in an appellate capacity . . . [but rather] functions as the forum of origin for a determination of both facts and law." [*Serv. & Erection Co.*] at 2 (quoting *Enerquin Air, Inc. v. State Tax Assessor*, 670 A.2d 926, 928 (Me. 1996)).

Underwood v. City Of Presque Isle, 1998 ME 166 ¶ 20, 715 A.2d 148. Neither the plain language of the statute nor that of the Court quoted above limits the scope of our review on appeal to those issues taken up during agency reconsideration. Rather, as to those cases meeting

the jurisdictional requisites, both the Board and the Superior Court, respectively,[6] serve as forums of origin regarding the assessment or determination as to which the person subjected is aggrieved under section 151(1). We are aware of no provision of law, and none has been provided, showing that the scope of our review is limited to the issues identified by the parties on MRS reconsideration.[7] We therefore proceed to address the merits of the assessment in this case.

2. Abatement of Tax

The tax amount at issue in this appeal relates to the Harvesters that the Company purchased in late [Year 5] and in early [Year 6]. The Company argues that the Harvesters are exempt from sales and use tax because they were used directly and primarily in the production of woodchip biomass fuel for sale.

Maine sales tax "is imposed on the value of all tangible personal property . . . sold at retail in this State." 36 M.R.S. § 1811. Where no sales tax is collected and paid, 36 M.R.S. § 1861 imposes a use tax "on the storage, use, or other consumption in this state of tangible personal property" that would otherwise be subject to Maine sales tax if purchased in this state. An exemption from sales and use tax is provided under 36 M.R.S. § 1760(31) for machinery and equipment purchased for use by the purchaser "directly and primarily in the production of tangible personal property intended to be sold." For purposes of the exemption, however, the definition of "production" does not include "wood harvesting operations." 36 M.R.S. § 1752(9-B). *See Great N. Nekoosa Corp. v. State Tax Assessor*, 540 A.2d 770, 772 (Me. 1988) ("[W]ood

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[6] A final decision of the Board may be appealed to the Superior Court de novo by either the taxpayer or MRS. In that event, "[t]he court shall make its own determination as to all questions of fact or law, regardless of whether the questions of fact or law were raised before the division within the bureau making the original determination or before the board." 36 M.R.S. § 151-D(10)(I).

[7] It should be noted that the scope of our review in no way impairs MRS's attempts "to resolve issues with the petitioner through informal discussion and settlement negotiations with the objective of narrowing the issues for an appeals conference or court review," as provided in 36 M.R.S. § 151(2)(B).

harvesting operations are specifically excluded from the definition of production by the third paragraph of section 1752(9-B). Although the . . . statute does not define 'wood harvesting operations,' . . . the plain and natural meaning of the term includes not only the cutting of the tree, but the removal of the limbs as well."). The Company has not shown that its purchases of the Harvesters were exempt from sales and use tax during the period at issue as being used in production under section 1760(31).[8] No adjustment to the assessment is warranted on this basis.

3. Abatement of Penalties

The assessment contains substantial understatement penalties in connection with the Company's failure to report and pay use tax on its purchases of the Harvesters. 36 M.R.S. § 187-B(4-A). Cancellation and abatement of penalties is governed by 36 M.R.S. § 187-B, which provides that MRS "shall waive or abate" any penalty if the taxpayer supplies "reasonable cause" for doing so. Reasonable cause includes, but is not limited to, any of the circumstances listed in section 187-B(7).[9] Here, the Company argues that the subject penalties should be abated because MRS led it to believe during its previous audit that purchases of Harvesters would be sales tax-exempt. *See* 36 M.R.S. § 187-B(7)(A) (penalties abated where failure to file or pay resulted directly from erroneous information provided by MRS). Prior to the period on appeal, MRS had advised the Company that the purchase of machinery and equipment for use in the production of

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[8] Effective July 1, 2013, P.L. 2011, ch. 657 § N-2 amended 36 M.R.S. § 2013, permitting a sales tax exemption for purchases of "depreciable machinery or equipment, for use in . . . commercial wood harvesting." Because the Company purchased the Harvesters prior to the effective date of that amendment, however, its purchases are not eligible for that exemption.

[9] Under 18-674 C.M.R. 100 § 203(5) (May 1, 2014) (Board Rule 100 section 203(5)), we take official notice that MRS also has an internal policy whereby it does not impose substantial understatement penalties on audit if (1) the understatement is discovered during a taxpayer's first audit or (2) the understatement relates to an issue that was not addressed on a prior audit. In this case, MRS disallowed trade-in credits in the amount of $[amount] against the sale price of the Harvesters. Although trade-in credit appears to be a "first time issue" on audit for the Company, it is not known why MRS did not grant relief from the substantial understatement penalties under its policy.

woodchip biomass fuel was exempt from sales tax. The Company contends that because it purchased and used the Harvesters to sever trees from the earth in the production of woodchip biomass fuel, the penalties at issue should be cancelled. In support of its position, the Company relies on MRS's prior audit determination that no sales tax was due on the Company's purchase of a feller-buncher which, similar to the Harvesters, was used to sever trees from the earth at the beginning of the woodchip biomass fuel production process. *See* footnote 3, above. This argument illustrates the Company's misunderstanding regarding the taxability of lumber harvesting machinery and equipment when purchased at casual sale, as well as the Company's misunderstanding of the time when production commences for purposes of the exemption for machinery and equipment purchased for use in production.[10]

We find that, although MRS did not directly mislead the Company regarding the applicability of the tax exemption for machinery and equipment used in production—which did not extend to machinery and equipment such as the Harvesters that sever trees from the earth—MRS did not sufficiently ensure during its prior audit that the Company understood the different tax treatments for such machinery and equipment, as more fully described in footnotes 1 through 4, above. Based upon the circumstances of this case, we conclude that the Company had reasonable cause to understate its use tax liability regarding its purchase of the Harvesters. Accordingly, we cancel the penalties contained in the assessment. *Cf. John Swenson Granite, Inc. v. State Tax Assessor,* 685 A.2d 425, 429 (Me. 1996) (penalties were properly upheld where the taxpayer had been the subject of two previous audits and was on notice that MRS considered their sales taxable). No further adjustment is warranted.

[10] As provided by 18-125 C.M.R. 303 § 1(1) (January 29, 2007), "'[p]roduction' as used in Sec. 1752(9-B) commences with the movement of raw materials to the first production machine after their receipt and storage at the production site (after receipt if the raw materials are not stored) and ends with the completion of the finished product. . . . *The acquisition of raw materials . . . do[es] not constitute production.*" (Emphasis added).

4. Abatement of Interest

The Company also requests that the interest contained in the assessment be abated. Interest accrues automatically on the amount of tax due, calculated from the last date prescribed for payment and is compounded monthly. 36 M.R.S. § 186. MRS may waive the interest if the failure to pay the tax at issue "is explained to the satisfaction" of MRS. *Id.* As recognized by the Maine Law Court, the interest requirement

> supports the reasonable purpose that the investment value of money retained by late payment of taxes should benefit the State, not the individual or entity that delayed payment. However, "[i]f [a taxpayer's] failure to pay a tax when required is explained to the satisfaction of [MRS], [MRS] may abate or waive the payment of all or any part of that interest." 36 M.R.S. § 186. This statutory language indicates legislative intent to confer upon [MRS] broad discretion to waive or abate the interest due on an unpaid tax when the delayed payment is satisfactorily explained.

Victor Bravo Aviation, LLC v. State Tax Assessor, 2012 ME 32 ¶ 8, 39 A.3d 65. The language of section 186 "indicates a highly discretionary standard that is not easily met by the taxpayer." *Id.* ¶ 14. Here, the Company has not met its burden of explaining satisfactorily its failure to pay sales tax on its purchases of the Harvesters when due. Consequently, the Board is unable to abate the interest assessed. No adjustment is warranted.

III. DECISION

Based on the evidence presented and for the reasons stated above, the penalties contained in the assessment are cancelled in full. We uphold the remainder of the assessment, consisting of tax and associated interest.

The Board may, in limited circumstances, reconsider its decision on any appeal. If either party wishes to request reconsideration, that party must file a written request with the Board within 20 days of receiving this decision. Contact the Appeals Office at 207-287-2864 or see the Board's rules, available at http://www.maine.gov/boardoftaxappeals/lawsrules/, for more

information on when the Board may grant reconsideration. If no request for reconsideration is filed within 20 days of the date of this proposed decision, it will become the Board's final administrative action. If either party wishes to appeal the Board's decision in this matter to the Maine Superior Court, that party must do so within 60 days of receiving this decision. During the 60-day period in which an appeal may be filed with the Superior Court, the Company may contact Maine Revenue Services at 207-624-9725 for the amount of tax that is currently due, together with any interest or penalties owed. After that 60-day period has expired, Maine Revenue Services will contact the Company with an updated amount of tax and any interest or penalties due at that time.

Issued by the Board: June 20, 2016