DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-0279
Sales and Use Tax
For the Tax Period 1999-2001

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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- Imposition of Use Tax on Sanitation Supplies and Equipment.

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-3-2 (a), IC 6-2.5-3-2 (b), IC 6-2.5-5-2 (a), IC 6-2.5-5-3, 45 IAC 2.2-5-10(c), *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind.1983), *Gross Income Tax Division v. National Bank and Trust Co.,* 79 N.E. 2d 651 (Ind. 1948), *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698, (Ind. App. 1975).

The taxpayer protests the assessment of use tax on certain items of tangible personal property.

2. Sales and Use Tax-Imposition of Use Tax on Floor Coating

Authority: IC 6-2.5-3-2 (b), IC 6-2.5-3-2 (a), IC 6-2.5-5-3.

The taxpayer protests the imposition of use tax on floor coating.

3. Sales and Use Tax-Imposition of Use Tax on Vinegar Holding Tanks

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-3-2 (b), 45 IAC 2.2-5-8(c), 45 IAC 2.2-5-8(g), IC 6-2.5-5-3, 45 IAC 2.2-5-10(d).

The taxpayer protests the imposition of tax on vinegar holding tanks.

4. Tax Administration-Imposition of Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2(b). .

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

STATEMENT OF FACTS

The taxpayer is a corporation that processes food products. After an audit for the tax period 1999-2001, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest, and penalty. The taxpayer agreed with some of the assessed items and protested the remainder of the assessment. A hearing was held and this Letter of Findings results.

1. Sales and Use Tax-Imposition of Use Tax on Sanitation Supplies and Equipment.

DISCUSSION

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

Indiana imposes an excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana. IC 6-2.5-3-2 (a). In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

There are a number of exemptions from the use tax pursuant to the statute. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948).

The taxpayer contends that many items, including the sanitation supplies and equipment, qualify for exemption pursuant to one of two statutory provisions. First, the taxpayer argues that the items qualify pursuant to the following provisions of IC 6-2.5-5-2 (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.

The taxpayer argues that the items could also qualify for exemption pursuant to the following provisions of IC 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.

Both exemptions share the basic elements that the item must be "directly used in direct production". Therefore, the Indiana Court of Appeals found in *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E. 2d 698, (Ind. App. 1975) that the court cases and interpretations of the manufacturing exemption also apply to the agricultural production exemption.

The taxpayer protests the assessment of use tax on raincoats, aprons, overalls, sleeves, gloves, boots, and helmets. The taxpayer closes down the processing line for cleaning. While the processing line is closed down, the taxpayer's employees wear the protested items to protect themselves from the caustic cleaning solutions.

American Dairy of Evansville, Inc. (supra) dealt specifically with the taxability of cleaning compounds and supplies at a facility producing food products for human consumption. The Court found that the cleaning compounds used to maintain a clean processing area as required by the Indiana State Board of Health were directly used in direct production and therefore qualified for exemption. However, the Court reached a different conclusion on the taxability of cleaning equipment such as sponges, scouring pads, towels, and mops. The Court found that these items were too far removed from the production process to satisfy the double direct requirement of the exemption.

The sanitation items involved in this protest are even further removed from the production process than American Dairy's sponges, scouring pads, towels, and mops. Therefore, they do not qualify for exemption.

FINDING

The taxpayer's protest is denied.

2. Sales and Use Tax-Imposition of Use Tax on Floor Coating

DISCUSSION

The taxpayer also protests the assessment pursuant to IC 6-2.5-3-2 (a) of use tax on a floor coating. The taxpayer contends that this floor coating qualifies for the manufacturing exemption pursuant to IC 6-2.5-5-3 (b). This is a special urethane slurry coating used in the filler room where product is placed into jars and cans. The coating is designed to keep food particles from penetrating into any floor cracks where bacteria could grow.

The floor coating producer's sales brochure indicates that the floor coating is designed "to increase abrasion and chemical resistance while improving cleanability" and protect against moisture penetration. These functions do not directly affect the direct production of the taxpayer's product. Rather, the flooring is removed from the process in much the same way as the taxable cleaning supplies such as mops and scouring pads.

FINDING

The taxpayer's protest is denied.

3. <u>Sales and Use Tax</u>-Imposition of Use Tax on Vinegar Holding Tanks

<u>DISCUSSION</u>

The taxpayer also protests the assessment of use tax pursuant to IC 6-2.5-3-2 (a) on vinegar holding tanks. The taxpayer argues that the vinegar tanks qualify for exemption from the use tax pursuant to IC 6-2.5-5-3 (b), which 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.

Pursuant to 45 IAC 2.2-5-8(c) equipment must have "an immediate effect on the article being produced" to qualify for the exemption. This requirement is defined at 45 IAC 2.2-5-8(g) as follows:

> "Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. . . . 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 in itself mean that the property "has an immediate effect upon the article being produced:. 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.

To qualify for this exemption, the vinegar tanks must be used during the production process. The standard for determining the parameters of the direct production process are found at 45 IAC 2.2-5-10(d) as follows:

> Pre-processing and post-processing activities. "Direct use" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.

The vinegar storage tanks hold enough vinegar for about eighteen (18) hours of production. They are constantly being refilled. They are located immediately outside the cook room and are connected to the cooking kettles with piping. The flow meters on the tanks control the number of gallons introduced to each cooking kettle.

The vinegar storage tanks store vinegar, a raw material for the processing of tomatoes. They do not have an immediate effect on the product. Although it is essential that there be tanks to hold

the vinegar prior to the production process, they are not part of the taxpayer's integrated production process. Therefore, they do not qualify for the exemption.

FINDING

The taxpayer's protest is denied.

4. Tax Administration-Imposition of Penalty

DISCUSSION

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

During the tax period, the taxpayer purchased without paying the sales or use tax on many clearly taxable items such as first aid supplies, file cabinets, oil dri, polo shirts, and office supplies. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

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