DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0028 ST
STATE GROSS RETAIL TAX
For Years 1992, 1993, 1994, AND 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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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.

ISSUES

I. **State Gross Retail Tax** – Exempt production equipment.

Authority: 45 IAC 2.2-5-12; 45 IAC 2.2-5-14; 45 IAC 2.2-3-15; IC § 6-2.5-5-3; Indiana Dept. of St. Revenue vs. RCA Corp., (1974) 310 N.E.2d 96

Taxpayer protesting assessment of sales tax on pilot plant production equipment.

II. **State Gross Retail Tax** – Property used to transport work in progress.

Authority: 45 IAC 2.2-5-8

Taxpayer protests the assessment of Indiana sales and use tax on tangible personal property used to transport work-in-process.

III. **State Gross Retail Tax** – Required environmental control equipment.

Authority: IC § 6-2.5-5-30

Taxpayer protests the assessment of tax on environmental control equipment required for compliance with federal environmental quality statutes.

IV. **State Gross Retail Tax** – Taxpayer submitting documents after audit.

Taxpayer requesting audit be amended based on new information.

V. **State Gross Retail Tax** – Demurrage.

Authority: IC § 6-2.5-4-10, 45 IAC 2.2-4-27(d)

Taxpayer protested the proposed assessment of sales tax on gas cylinder demurrage charges.

VI. **State Gross Retail Tax** – Prescription safety glasses.

Authority: 45 IAC 2.2-5-28

Taxpayer protests the assessment of tax on prescription safety glasses purchased for employees.

VII. **State Gross Retail Tax** – Taxpayer records in error.

Taxpayer requesting audit revisions based on corrected information in taxpayer records.

VIII. **State Gross Retail Tax** – Lump sum contracts for improvements to real property.

Authority: 45 IAC 2.2-4-22; 45 IAC 2.2-4-26; IC § 6-2.5-3-2

Taxpayer protests the assessment of tax on environmental control equipment required for compliance with federal environmental quality statutes.

IX. **State Gross Retail Tax** – Procedural Issues.

Corrections of errors and oversights in audit and taxpayer records.

X. **State Gross Retail Tax** – Statute of limitations.

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

Taxpayer protests the assessment of tax on transaction alleged to be outside statute of limitations.

XI. **State Gross Retail Tax** – Negligence penalty.

Authority: 45 IAC 15-11-2; Ind. Code § 6-8.1-10-2

Taxpayer protests the assessment of negligence penalty.

STATEMENT OF FACTS

Taxpayer is a specialty chemical manufacturer. Taxpayer's large-scale production facilities are located outside of Indiana. Products that are manufactured which do not require a full plant quantity production run are produced at Taxpayer's Indiana pilot plant. These small production runs are for some marketed products and some research and product development projects.

I. **State Gross Retail Tax** – Exempt production equipment.

DISCUSSSION

Tax exemptions were granted by the state for equipment purchased for the pilot plant and used for production of items that were sold, as allowed under 45 IAC 2.2-5-12 and 45 IAC 2.2-5-14. If taxpayer records did not indicate the equipment was used to manufacture products made and sold, the exemption was denied because the taxpayer used the goods for their own purposes, which is taxable per 45 IAC 2.2-3-15 and 45 IAC 2.2-5-14(b).

Taxpayer maintains that all manufacturing equipment purchased for a "pilot plant" where some products are produced and sold and some are items produced as part of research and development projects should be exempt. Taxpayer cites Ind. Code § 6-2.5-5-3 as providing an exemption for manufacturing equipment used in the production of tangible personal property. In response to the audit, taxpayer states, "This (audit's) position, however, ignores the fact that all products at issue were produced with the intent to sell." Appeal of 9/25/97 page 3.

The Court defined IC § 6-2.5-5-3 in Indiana Dept. of St. Revenue vs. RCA Corp., (1974) 310 N.E.2d 96, at 97, "We hold that the language is ambiguous and, since it provides a tax exemption, it must be strictly construed against the taxpayer." The pilot plant is for Research and Development purposes, such activity is not exempt under IAC 2.2-5-14(b) which states:

> The exemption provided by this regulation [45 IAC 2.2] applies only to tangible personal property to be incorporated as a material or an integral part into tangible personal property produced for sale by a purchaser engaged in the business of manufacturing, assembling, refining or processing. This regulation [45 IAC 2.2] *does not apply to persons*

> *engaged in producing tangible personal property for their own use.* (Emphasis added)

In addition, as was noted in RCA,

> The Indiana Legislature wrote its exemption in words different from those used in any statute construed in the cases RCA cites, or in any cases we have read. Indiana requires that for the sale to be exempt the property purchases must not only be "used directly" in the manufacturing process (as do the statutes of other states) but that it must be "*directly* used…in the *direct* production, manufacture,"etc.
> ….
> Since it is reasonable to assume that the legislative purpose in repeating the directness requirement was to avoid what may have been considered overly broad judicial construction of the single directness requirement in other states, we feel obliged to give it the narrow construction we have indicated. Indiana Dept. of St. Rev., Sales Tax Div. V RCA Corp., (1974) 310 N.E. 2d 96 at 100

Taxpayer plant was not a manufacturing site for commercial products, the fact that some of the items produced there were sold is incidental. An exemption was granted for the equipment used in an exempt production capacity. Taxpayer's occasional sale of various items does not create a manufacturing exemption for all equipment on site; consequently, the equipment is not exempt.

FINDINGS

Taxpayer's protest is denied.

II. State Gross Retail Tax – Property used to transport work in progress.

DISCUSSSION

Taxpayer protests the assessment of and lack of credit given for Indiana sales and use tax on tangible personal property used to transport work-in-process. Tax was assessed on forklifts that were used in the manufacturing process to transport work-in-process between steps of production; these forklifts were used for this work 50% of the time. With regard to such equipment 45 IAC 2.2-5-8(f)(3) provides the following:

> Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

Equipment used in an exempt manner or partly used in an exempt manner is exempt from the tax on the appropriate percentage used in an exempt manner; however, taxpayer bears

the burden of demonstrating this exempt usage. Consequently; provided taxpayer can provide proof of the exempt usage, taxpayer is sustained.

FINDINGS

Taxpayer's protest is sustained pending verification by audit.

III. State Gross Retail Tax – Required environmental control equipment.

DISCUSSSION

Taxpayer was assessed state gross retail tax on purchases related to the construction of drum dike storage flooring. With regard to such equipment, Ind. Code § 6-2.5-5-30 provides the following:

> Sales of tangible personal property are exempt form the state gross retail tax if:

(1) The property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state local, or federal environmental quality statutes, regulations, or standards; and
(2) The person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Taxpayer was required to install drum dike flooring-essentially a retention pond- at an outside storage location to comply with Environmental Protection Agency standards for chemical storage. The flooring served no other function than compliance with these standards. Therefore, as taxpayer is engaged in the business of manufacturing and used this property in its manufacturing operations to comply with the environmental quality standards it is exempt from the state gross retail tax.

FINDINGS

Taxpayer's protest is sustained.

IV. State Gross Retail Tax – Taxpayer submitting documents after audit.

DISCUSSSION

During the audit, information was requested -but never received- relating to various payments made by taxpayer. As a consequence, the Indiana gross retail tax was assessed on these payments. As part of taxpayer's appeal, this information is now being provided with the request that these payments be exempt from the Indiana Gross Retail Tax since the payments were actually for professional services rendered. As no legal issue exists,

inasmuch as the auditor was never provided an opportunity to review this information prior to this appeal, this information will be reviewed by the audit department as to its sufficiency for an exemption from the Indiana Gross Retail Tax.

FINDINGS

Taxpayer's protest is sustained pending verification by audit.

V. **State Gross Retail Tax** – Demurrage.

DISCUSSSION

Taxpayer appeals use tax assessment on payments made for use of gas storage cylinders. Taxpayer describes the payments as demurrage, taking the nature of a penalty payment. The word demurrage is generally understood as the charge a carrier makes for the detention of a cargo conveyance. It only makes sense that should a carrier be deprived of his conveyance beyond a bargained for time the carrier should be compensated. In this case, if the gas vendor does not have the use of the cylinder beyond some preagreed date the taxpayer is charged a late fee. It is billed separately at the time of the sale of the cylinder contents after the cylinder's return. The taxpayer has not bargained for a rental of the cylinder. The fee is being charged for late return of the cylinders and not in exchange for use of the cylinders.

FINDINGS

Taxpayer's protest is sustained.

VI. **State Gross Retail Tax** – Prescription safety glasses.

DISCUSSSION

Taxpayer protests assessment of tax based on its purchase of prescription safety glasses for employees. Taxpayer identifies 45 IAC 2.2-5-28(f) as an exemption for eye glasses; to wit:

> The sale to the user of eyeglasses or contract lenses prescribed by one licensed to do so is exempted from sales tax. The *exemption to the patient* applies whether the item is sold by the practitioner or by a dispensing optician. (Emphasis added)

The code specifically applies the exemption to the user, further identified within the cited code as the patient. Taxpayer corporation is purchasing the glasses for its employees, not as a user or patient.

FINDINGS

Taxpayer's protest is denied.

VII. State Gross Retail Tax – Taxpayer records in error.

DISCUSSSION

Taxpayer was assessed tax on items purchased outside of Indiana and, per the information available at the time of the audit, apparently shipped to Indiana. Taxpayer has now located the original bills of lading and invoices that indicate the items were shipped outside of Indiana. Accordingly taxpayer requests a reduction to the proposed assessment.

FINDINGS

Taxpayer's protest is sustained pending verification by audit.

VIII. State Gross Retail Tax – Lump sum contracts for improvements to real property.

DISCUSSSION

Taxpayer protests the imposition of use tax on items purchased for improvements to real property and paid for by lump sum contracts. Taxpayer notes IC § 6-2.5-3-2, which provides:

> (c) The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located. However, the use tax does not apply to additions of tangible personal property described in this subsection, if:
>
> (1) The state gross retail or use tax has been previously imposed on the sale or use of that property….

In this assessment, taxpayer had not paid sales tax on any of the purchased items. Taxpayer notes that 45 IAC 2.2-4-26 suggests the contractor should have paid the tax at the time of the purchase. Additionally; 45 IAC 2.2-4-22(e)(3) requires:

> Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the department of Revenue when he disposes of such property in the following manner:

….

(3) Lump Sum Contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

Thus, provided the taxpayer can provide documentation in the form of invoices or contracts that confirm that the items at issue are lump-sum billings for improvements to realty, taxpayer's protest is sustained

FINDINGS

Taxpayer's protest is sustained pending verification by audit.

IX. State Gross Retail Tax – Procedural Issues

DISCUSSSION

As part of the appeal, taxpayer requests several corrections. Taxpayer indicates one purchase was erroneously coded by the auditor to expense account 75912200 when it was charged to account 75932251, one account was reclassified during the sample period from account 75900252 to account 75956252, and several purchases were classified both as an expense projection and as capital assets and should be removed from the expense projection classification. Taxpayer requests credit be given for Indiana sales and use tax previously paid by taxpayer and that an aircraft fuel purchase made at an out of state vendor's location be removed from the assessment. Taxpayer also notes that additional information requested by the auditor and not provided until this appeal will allow manufacturing project credits for purchases charged to manufacturing projects. These requests involve no legal issues, rather they are issues that taxpayer failed to address during the audit process, therefore they are subject to verification by the auditor.

FINDINGS

Taxpayer's protest is sustained pending verification by audit.

X. State Gross Retail Tax – Statute of limitations

DISCUSSSION

Taxpayer is protesting the assessment on purchases made by its sister corporation and then transferred to taxpayer. The purchases made by the sister corporation were during the calendar year of 1991, the transfer to taxpayer's corporation did not occur until April of 1992. Taxpayer notes that the Department cannot assess tax on purchases made in 1991 as the transactions occurred outside the current statute of limitations, IC § 6-8.1-5-2. The tax is imposed under IC § 6-2.5-3-2, which requires:

(a) 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.

Indiana Code § 6-2.5-4-1, defines selling at retail as:

> (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.

The transfer from the sister corporation to the taxpayer can constitute a taxable event for taxpayer; indeed, the 1991 purchase did not involve the taxpayer and could not be assessed against the taxpayer. The April 1992 purchase did fall within the audit period and was properly assessed against taxpayer.

FINDINGS

Taxpayer's protest is denied.

XI. State Gross Retail Tax – Negligence penalty.

A negligence penalty of 10 percent was assessed against taxpayer based on the penalty prescribed in Ind. Code § 6-8.1-10-2. The code authorizes the Department of Revenue in Ind. Code § 6-8.1-10-2(f):

> The department shall prescribe, by rules and regulations adopted under IC 4-22-2, circumstances which constitute reasonable cause and negligence for purposes of this section.

The department defines negligence in relevant part in 45 IAC 15-11-2(b) as:

> "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….

A substantial portion of taxpayer's protest involved documentation and information that taxpayer failed to provide the auditor, either during the audit or, in several instances, on

the original returns. These actions alone are sufficient evidence of a lack of reasonable care and diligence to impose the negligence penalty.

FINDINGS

Taxpayer's protest is denied.

JM/PE/MR--002101