

Letter of Findings Number: 05-0018
Sales and Use Tax
Tax Period 2001-2003

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ISSUES

I. Sales and Use Tax-Manufacturing Exemptions

Authority: IC § 6-8.1-5-1(b); IC § 6-8.1-5-4; IC § 6-2.5-3-2(a); IC § 6-2.5-5-3; IC § 6-2.5-5-1(b); [45 IAC 2.2-5-10](#); *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E.2d 651 (Ind. 1948); *Indiana Department of Revenue v. Cave Stone*, 457 N.E.2d 520 (Ind. 1983).

The taxpayer protested the assessment of use tax on certain items which it alleges qualified for the manufacturing exemption.

II. Sales and Use Tax-Services

Authority: IC § 6-2.5-2-1; IC § 6-2.5-4-1(b); IC § 6-2.5-4-6.

The taxpayer protested the assessment of sales tax on certain services.

III. Sales and Use Tax-Credit for Sales Tax Paid

Authority: IC § 6-2.5-3-4(a).

The taxpayer protested the assessment of use tax on items on which it claims it paid sales tax at the time of purchase.

IV. Tax Administration- Ten Percent Negligence Penalty

Authority: IC § 6-8.1-10-2.1: [45 IAC 15-11-2\(b\)](#).

The taxpayer protested the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

The taxpayer is a metal supplier, steel parts fabricator, and manufacturer of motor homes, trailers, and recreational vehicles. After an audit, the Indiana Department of Revenue (department) assessed additional sales tax, use tax, interest, and penalty. The taxpayer protested this assessment. A hearing was held and this Letter of Findings results.

I. Sales and Use Tax- Manufacturing Exemptions

DISCUSSION

Notices of proposed assessments are prima facie evidence that the department's claim for unpaid taxes is valid. IC § 6-8.1-5-1(b). The taxpayer has the burden of proving that the department incorrectly imposed the assessment. *Id.* Taxpayers are required to keep adequate books and records so that the department can determine the proper tax owed to the state. IC § 6-8.1-5-4.

Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. IC § 6-2.5-3-2 (a). A number of exemptions are available from use tax, including those collectively referred to as the "manufacturing exemptions." IC § 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication... of tangible personal property." *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) stands for the proposition that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. *Indiana Department of Revenue v. Cave Stone*, 457 N.E.2d 520 (Ind. 1983) 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. [45 IAC 2.2-5-10\(h\)\(2\)](#) further clarifies the exemption by allowing the exemption of "Replacement parts, used to replace worn, broken, inoperative or missing parts or accessories on exempt machinery and equipment..." IC § 6-2.5-5-1(b) provides for a parallel exemption for property directly consumed in the direct manufacturing process. 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, 653 (Ind. 1948).

The taxpayer fabricated metal products for use primarily in recreational vehicles. It had two operating divisions, "A" and "B." The taxpayer produced its products in nine different buildings at its location. One building was primarily for storage of steel coils. Another building was used for packaging, storing, and shipping of final product. The remainder of the buildings were used for the steps of cutting, forming, punching, and welding hot rolled, cold rolled, hot rolled pickled and oiled, galvanized and galvanealed steel and aluminum.

The taxpayer had several pieces of equipment used to move items in various stages of pre-production, production, and post-production activities. In division A, steel coils were unwound, flattened, and the initial cuts were made. The machines from Division A on which tax was assessed included a twenty-ton overhead crane, a

fifteen-ton overhead crane, a heavy duty Taylor diesel powered lift truck referred to as "big red," three propane powered 15,000 pound Kalmar lift trucks, and a 5,000 pound lift truck. The auditor assessed use tax on 100 percent of the expenses of big red. The auditor assessed use tax on 75 percent of the expenses of the remainder of these pieces of equipment. The department assessed tax in this manner since it felt these figures accurately reflected the percentage of the time that the equipment was used in pre production and post production. The taxpayer protested this assessment contending that the products were produced in an integrated work process and the department misapprehended the amount of the use that was directly used in the direct production process. The taxpayer contended that the production process began when the steel coils were unwound and ended with packaging in the shipping building in Division B. Therefore, only about 20 percent of the machinery was used pre and post production and subject to the imposition of use tax.

The taxpayer had twenty additional Mitsubishi and Toyota lift trucks and mechanical lifts dedicated to specific machines in Division B. The auditor assessed use tax on 50 percent of the cost of purchases related to the use of these lift trucks and mechanical lifts. The taxpayer protested this assessment on the basis that the equipment was directly used in the integrated manufacturing process and claimed a 90 percent exemption.

The taxpayer also protested the assessment of use tax on gasoline consumed in the operation of the previously described equipment. The taxpayer contended that the gasoline qualified for exemption as directly consumed in the direct production process in the same proportion as the use of the equipment qualified for the exemption.

The taxpayer presented a statement of what it alleged this equipment did for a period of a few hours as evidence that the audit's assessment of the taxable use of the equipment was incorrect. The audit assessment was based on the auditor's review of the equipment's usage. The audit assessed tax at the same rate as the previous audit. The taxpayer did not produce adequate evidence to sustain its burden that the audit's assessment was incorrect.

The taxpayer also protested the assessment of use tax on certain safety clothing and equipment contending that these items were directly used in the direct production process. The department allowed exemptions for many items of safety clothing and equipment. The only items on which the department assessed tax were string gloves, maintenance gloves, and vinyl screens around welding areas. The taxpayer did not produce any documentation to prove that these items were actually directly used in the direct production process. The taxpayer did not sustain its burden of proving that these items qualified for exemption.

The department assessed use tax on an AutoCAD software package which was used to create digital files. The taxpayer contended that this software was used in an exempt manner to prepare software to operate machinery ten percent of the time. Therefore, ten percent of its value would qualify for exemption from the use tax. Software used to operate machinery can qualify for the manufacturing exemption. In this case, however, the use tax was assessed on the software package that created the software to operate the machinery. The AutoCAD machinery did not directly affect the manufacture of the taxpayer's product. It did not qualify for exemption from the use tax for the ten percent of the time it was used to create software to operate the production machinery.

During the tax period the taxpayer purchased several items of machinery for its facilities. The taxpayer contended that all of these items qualified for exemption as directly used in direct production. The items included an uncoiler, reference #126 and 226; a lift table, reference #4372401, two powered reels and two air feeds, reference #68256; and a Mech Vac Lifter, reference #4903501. The taxpayer failed to sustain its burden of proving that these items were used in the production process in a manner that qualified them for exemption from the use tax.

The department also assessed tax on diesel fuel. The taxpayer alleged that 10 percent of this fuel was used in exempt machinery. The taxpayer offered statements of how much diesel fuel was used in the factory to support its contention. The statements were not conclusive as to the amounts used and did not necessarily conform with the department's determination of the taxability of various machines. The taxpayer failed to sustain its burden of proving that the department erred in its assessment on diesel fuel.

FINDING

The taxpayer's protest is denied.

II. Sales and Use Tax-Services

DISCUSSION

The taxpayer contended that the department incorrectly imposed sales tax on certain services. Specifically, the taxpayer contended that the department incorrectly assessed sales tax on shipping charges, internet provision services, and services related to production machinery repairs.

Indiana imposes a gross retail or sales tax on retail sales in Indiana. IC § 6-2.5-2-1. A retail sale is a transfer of tangible personal property for consideration. IC § 6-2.5-4-1(b). Except for certain enumerated services, the provision of services is not subject to the Indiana sales tax.

Telecommunication services are specifically enumerated as a service subject to the imposition of the sales and use taxes. IC § 6-2.5-4-6. "Telecommunication service" is defined as "the transmission of messages or information by or using wire, cable, fiberoptics, laser, microwave, radio, satellite, or similar facilities...." *Id.* Internet services meet this definition. Therefore, the provision of internet services is subject to the sales and

complementary use tax.

The taxpayer did not produce any documentation to establish that the department assessed tax on delivery charges or services related to the repair of machinery or any other exempt tangible personal property. Therefore, the taxpayer did not sustain its burden of proving that the tax was improperly imposed in these instances.

FINDING

The taxpayer's protest is denied.

III. Sales and Use Tax-Credit for Sales Tax Paid

DISCUSSION

The taxpayer protested the assessment of use tax on three items. The taxpayer contended that the use of these items was exempt from the use tax pursuant to IC § 6-2.5-3-4(a) because the taxpayer had paid the sales tax at the time of purchase.

The taxpayer submitted two invoices indicating that sales tax had been paid at the time of purchase. The first was for a Snapper Joystick Tractor and Deck purchased on July 10, 2001. The second invoice indicated that sales tax was paid on the December 12, 2000, purchase of a copy machine. The taxpayer sustained its burden of proving that the use of these three items are exempt from the use tax.

FINDING

The taxpayer's protest to the imposition of use tax on the tractor, deck, and copier is sustained.

IV. Tax Administration- Ten Percent Negligence Penalty

DISCUSSION

The taxpayer protested 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.

The taxpayer failed to follow the department's instructions and remit use tax on gas and parts used forklifts in the amount directed in the previous audit. The taxpayer also failed to remit use tax on clearly taxable items such as office supplies, cleaning supplies, and gifts. These breaches of the taxpayer's duty to properly report and remit sales and use taxes constituted negligence.

FINDING

The taxpayer's protest is denied.

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