

Letter of Findings: 06-0282
Gross Retail Tax
For the Years 2002, 2003, and 2004

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ISSUES

I. Preproduction – Gross Retail Tax.

Authority: IC § 6-2.5-3-2(a); IC § 6-8.1-5-1(b); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-10](#); [45 IAC 2.2-5-10\(a\)](#); [45 IAC 2.2-5-10\(c\)](#); [45 IAC 2.2-5-10\(d\)](#); [45 IAC 2.2-5-10\(k\)](#).

Taxpayer disagrees with the audit's delineation of when taxpayer's "dross" refining process begins.

II. Mold Set-Up Equipment – Gross Retail Tax.

Authority: [45 IAC 2.2-5-10\(c\)](#); [45 IAC 2.2-5-8\(g\)](#).

Taxpayer argues that equipment used to transport molds is integral to taxpayer's production of aluminum ingots.

III. Equipment Used to Move Aluminum Ingots – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(f\)\(3\)](#).

Taxpayer claims that equipment used to move aluminum ingots is integral to taxpayer's production process.

IV. Environmental Regulation Compliance – Gross Retail Tax.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-5-30; [45 IAC 2.2-5-70](#); [45 IAC 2.2-5-70\(a\)](#); *Harlan Sprague Dawley, Inc. v. Indiana Dept. of State Revenue*, 605 N.E.2d 1222, (Ind. Tax Ct. 1992).

Taxpayer argues that equipment related to the disposition of waste "salt cake" is exempt from sales tax because the equipment was acquired in order to comply with environmental quality standards.

STATEMENT OF FACTS

Taxpayer is an industrial refiner operating a "batch processing plant" which processes "dross," scrap aluminum, and used beverage containers. "Dross" consists of the mass of solid impurities floating on a molten metal bath which is recovered during aluminum smelting. The subsequent recovery of aluminum from the "dross" makes up a majority of the taxpayer's activity. In effect, taxpayer acquires dross and scrap aluminum, processes those materials, and produces aluminum ingots.

Depending on the current aluminum market price, taxpayer may operate as a retail merchant selling refined aluminum product which they own to other manufacturers, refiners, or processors. Alternatively, taxpayer may operate as an industrial processor on behalf of others. In those circumstances, taxpayer accepts materials owned by another, processes those materials, and returns the refined product to the owner in the form of aluminum ingots.

Taxpayer operates a plant which contains five natural gas furnaces. Taxpayer accepts materials in "batches." Each "batch" has a unique metal content. The batches are shipped to taxpayer's location in trailers. Each "batch" may consist of one or more truckloads of materials. Since the materials contained in the truckload have been analyzed for metal content by the shipper, the truck contents are reweighed at taxpayer's location only to verify the amount contained in each truck.

The truck is unloaded and the contents are stored as a segregated identifiable batch on the concrete floor of a covered warehouse building. The stored batches remain segregated throughout the process and the batches are not combined for processing. The batches remain segregated because the purchase price of the dross – what taxpayer pays to its suppliers – is dependent on the aluminum content and grade of each particular batch; the content and grade cannot be determined until after the particular batch is smelted.

Taxpayer's recovery process works like this; the five rotary furnaces operate five days a week 24 hours a day. Normally three of the furnaces are in operation. As one furnace is being cleaned and prepared for receiving a new batch, the new batch is "staged" in the charging area in front of that furnace. The new batch is transported by a front-end loader from the covered warehouse building. As each new batch is transported, it is weighed at the scales.

The aluminum recovery process requires addition of a flux to draw off the waste metals and inert materials. The flux material used by taxpayer consists of special salts and potash ingredients. The flux materials are stored in storage bins and are brought to the charging area. The amount of flux is determined by the batch analysis provided by the shipper and the relative weight of the dross materials transported by a front-end loader.

When both the flux materials and the batch are in place, the rotary furnace – which looks like an oversized concrete truck mixer – is hydraulically tilted. The furnace doors are opened and the flux is first added. Once the flux has obtained a "wet" state, the corresponding load of dross is added. The furnace doors are closed and the furnace is tilted up. The dross eventually reaches a liquid state. As the furnace rotates, the flux floats to the top of

the liquid aluminum. As the flux floats to the top, it draws impurities and other metals from the liquid aluminum. The resulting combination creates waste slag.

While the dross is being processed in the furnace, molds are transported to and staged at the face of the furnace. After the refining process is complete, the furnace is tilted slowly down. The aluminum pours out of the tilted furnace beneath the floating slag and into a movable channel. The movable channel directs the aluminum into the various molds where the molten aluminum is allowed to cool. Before the aluminum is fully cooled, the unit is stamped with a batch identification number along with the grade of the aluminum as determined by the taxpayer's analysis of the finished product. Once cooled, the finished aluminum unit is fully cooled, the unit is removed from the mold and transported by forklift to the finished goods storage area.

After the aluminum has been drawn from the furnace, the molten slag remains in the furnace. This remaining slag is called "salt cake." The salt cake is poured from the furnace and directed into salt cake pans. These salt cake pans are moved to another area of taxpayer's building where the salt cake is allowed to cool and solidify. Once the salt cake has cooled, it is removed from the pans by taxpayer's forklift and placed on a concrete floor. The salt cake is moved by a loader into the taxpayer's dump trucks and transported for disposal at the taxpayer's landfill site.

The Department of Revenue (Department) conducted an audit review of taxpayer's returns and business records. The audit resulted in the assessment of additional use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representative explained the basis for the protest. This Letter of Findings results.

Taxpayer's detailed protest challenges the audit's conclusion as to approximately 1,400 individual items. The individual items fall into four different purportedly exempt categories which are addressed herein.

I. Preproduction – Gross Retail Tax.

DISCUSSION

Taxpayer disagrees with the audit's determination of when the dross refining begins.

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

The Department found that use tax was due on purchases that Taxpayer had made without paying sales tax on them. Indiana imposes "an excise tax, known as the use tax," on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a). Taxpayer maintains that is an "industrial processor," which is allowed an exemption from sales and use tax on machinery, tools, and equipment used in direct production under [45 IAC 2.2-5-10](#).

Pursuant to [45 IAC 2.2-5-10\(a\)](#) "[i]n general, all purchases of tangible personal property by persons engaged in the processing or refining of tangible personal property are taxable."

However, Indiana law allows for an exemption from sales and use tax for "manufacturing machinery, tools, and equipment used in direct production." Property that is acquired for "use in direct production" is defined in [45 IAC 2.2-5-10\(c\)](#) as the "manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining" and that has "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-10\(c\)](#). This exemption is extended to "industrial processors, as defined in IC § 6-2.5-4-2." As [45 IAC 2.2-5-10\(a\)](#), in relevant part, instructs:

[A]n industrial processor, as defined in IC § 6-2.5-4-2, is one who:

- (1) acquires tangible personal property owned by another person;
- (2) provides industrial processing or servicing, including enameling or plating, on the property; and (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

Processing or refining is defined in [45 IAC 2.2-5-10\(k\)](#), as follows:

Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different than that in which it was acquired. The change in form, composition, or character must be a substantial change. Operations such as distilling, brewing, pasteurizing, electroplating, galvanizing, anodizing, impregnating, cooking, heat treating, and slaughtering of animals for meal or meal products are illustrative of the types of operations which constitute processing or refining, although any operation which has such a result may be processing or refining. A processed or refined end product, however, must be substantially different from the component materials used.

Taxpayer argues that the processing begins with the initial weighing of each individual batch and that all of the equipment used in moving the dross from the scale to the charging area is used in the direct production of taxpayer's aluminum ingots. The audit concluded that the equipment in question was part of taxpayer's "pre-production." In support of its position, taxpayer cites to [45 IAC 2.2-5-8\(d\)](#).

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the

production has altered the item to its completed form, including packaging, if required. [Example] (1) The production of pharmaceutical items is accomplished by a process which begins with weighing and measuring out appropriate ingredients, continues with combining and otherwise treating the ingredients, and ends with packaging the items. Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and is taxable. Weighing and measuring equipment and all equipment used as an essential and integral part of the subsequent manufacturing steps, through packaging, qualify for exemption. Equipment which loads packaged products from the packaging step of production into storage, or from storage into delivery vehicles is subject to tax.

Taxpayer argues that its aluminum ingot production begins with the operation of the front end loader as described above. ("The new batch is transported by a front-end loader from the covered warehouse building. As each new batch is transported, it is weighed at the scales.") Taxpayer cites to an unpublished Tax Court decision, *Colonial Brick, Corp., v. Dept. of State Revenue*, 1998 Ind. Tax LEXIS 70 (1989), for support of its position that the front end loader and the associated parts are exempt from sales tax. In that case, the petitioner paid the sales tax, and then sought a refund for the amount of sales tax paid on two loaders that were used for mixing sawdust and coal and for feeding the mixture into kilns for brick burning. The court found that the mixing of the coal and the sawdust was more than storage; it was an integral and essential part of the process of making bricks. It set into motion the whole process by which petitioner "burns" its bricks. The court concluded that petitioner's production process, for purposes of the exemption, began with the mixing of the coal and the sawdust.

In taxpayer's process, the front end loader is used to weigh each segregated "batch" of raw materials to verify the amount contained within that batch. Hence, taxpayer production process is distinguishable from the process described in *Colonial Brick* where the petitioner's front end loaders were used to combine coal and sawdust. Taxpayer is in the business of processing various aluminum byproducts into ingots. The production of those ingots begins at the point where the various constituent elements – including the waste aluminum and flux – are introduced into the rotary furnaces. Taxpayer depends on the waste aluminum supplier's information to determine the amount of flux to be added to each batch. Therefore, the equipment for which seeks the exemption is better classified as "pre-production" because it is equipment used prior to the "integrated production process" by which taxpayer produces the finished aluminum ingots. The equipment falls within that category of non-exempt equipment described in [45 IAC 2.2-5-8\(d\)](#) as follows:

Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and is taxable.

FINDING

Taxpayer's protest is respectfully denied.

II. Mold Set-Up Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer argues that the forklifts used to position the empty molds in front of the furnaces is exempt because placing the molds in front of the furnaces is "integral and essential to the process." The audit report indicated that the "placing of the molds is not integral to the process."

Taxpayer explains that its furnaces can only fill molds that are placed within reach of the furnace mouth. Taxpayer argues that forklifts used to place the molds in position are "integral and essential to the [manufacturing] process." As described above in the Statement of Facts, "While the dross is being processed in the furnace, molds are transported to and staged at the face of the furnace." Taxpayer indicates that it could not produce metal ingots if the molds were not placed into position.

The Department is prepared to agree that positioning the molds is necessary to the production of the ingots. However, the Department is not prepared to agree that the forklifts' function falls within the "integrated process which produces tangible personal property." [45 IAC 2.2-5-10\(c\)](#). The positioning of the molds within reach of the furnaces is necessary but "necessity" is not the means by which exemption is tested. "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 itself mean that the property 'has an immediate effect upon the article being produced.'" [45 IAC 2.2-5-8\(g\)](#). The Department must conclude that the positioning of the molds does not constitute "an integral part of an integrated process which produces tangible personal property." *Id.*

FINDING

Taxpayer's protest is respectfully denied.

III. Equipment Used to Move Aluminum Ingots – Gross Retail Tax.

DISCUSSION

Taxpayer argues that production of the finished ingots ends at the time taxpayer weighs the completed aluminum ingot. As explained by taxpayer, "The weighing of the [ingots] is essential because the weight of each melt is compared to the weight of the charge to determine the recovery percentage. Until [taxpayer] weighs the [ingots], they do not know how much metal they have produced, and thus [cannot] value the [ingots], or determine their purity." The audit disagreed finding that the aluminum ingot is completed at the point where the ingot is removed from the mold. According to the audit report, "[T]he examiner finds that this activity is not part of the integrated refining process. It is a taxable post-production process that is performed on the finished aluminum

goods after the processing has been completed."

Taxpayer is in the business of refining/reprocessing waste aluminum. This process concludes with the production of metal ingots. Taxpayer points out the obvious necessity of determining whether the individual ingot weighs 5 pounds, 500 pounds or 5,000 pounds. The exemption taxpayer seeks is found at [45 IAC 2.2-5-8\(f\)\(3\)](#) which states that, "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." Since taxpayer's "production process" is complete with the casting of the ingots, the equipment used to move the ingots subsequent to the casting is not exempt.

FINDING

Taxpayer's protest is respectfully denied.

IV. Environmental Regulation Compliance – Gross Retail Tax.

DISCUSSION

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. However, Indiana law allows manufacturers an exemption for items which are purchased for the purpose of complying with environmental quality standards. The exemption is set out in IC § 6-2.5-5-30 which states in part that, "Sales of tangible personal property are exempt from the state gross retail tax if... the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards...." The Department's regulation restates the exemption as such:

The state gross retail tax does not apply to sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local or federal environment [quality] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture. (1) Consumed as used in this regulation... means the dissipation or expenditure by combustion, use or application and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, machinery, devices or furnishings. (2) Incorporated as used in this regulation... means the material must be physically combined into and become a component of the environmental quality device, facility, or structure. The material must constitute a material or integral part of the finished product. [45 IAC 2.2-5-70\(a\)](#).

There is no dispute that the salt cake qualifies as a "solid waste" and that taxpayer is required to dispose of the salt cake in a manner which comports with Indiana law. As explained by taxpayer's representative; Landfills containing solid waste and solid waste disposal issues are governed by the Solid Waste Management Board which is a division of the Indiana Department of Environmental Management. [Taxpayer] must apply for authority to operate the landfill directly with the Solid Waste Management Board. The landfill is designed and maintained so as to allow [taxpayer] to dispose of the salt cake in a manner that complies with Indiana state law.

Tax exemptions are strictly construed against the taxpayer, and the taxpayer bears the burden of demonstrating entitlement to the exemption. See *Harlan Sprague Dawley, Inc. v. Indiana Dept. of State Revenue*, 605 N.E.2d 1222, 1225 (Ind. Tax Ct. 1992). However, when construing an exemption,... the court must always bear in mind the legislature's intent to avoid reading the exemption so narrowly its application is defeated in cases rightly falling within its ambit." *Id.*

Taxpayer has met its burden of demonstrating that three items are exempt pursuant to IC § 6-2.5-5-30. Taxpayer has provided sufficient information to establish that the diesel truck, diesel fuel, and one forklift are exempt items. Taxpayer has not met its burden of demonstrating that the remaining claimed or suggested items are exempt pursuant to IC § 6-2.5-5-30.

FINDING

Taxpayer's protest is sustained as to the forklift, diesel truck, and diesel fuel.

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