

Letter of Findings: 06-0476
Use Tax
For Tax Years 2002-04

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ISSUE

I. Use Tax—Overpayment.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-2.5-5-30; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-70](#); [Sales Tax Information Bulletin 60](#) (July 2006).

Taxpayer requests refund of use tax.

STATEMENT OF FACTS

Taxpayer is a corporation involved in steel manufacturing, with operations in Indiana and other states. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer was entitled to refunds of use tax for the tax years 2002, 2003, and 2004. The Department determined Taxpayer's status by adding overpayments and underpayments and arriving at a final figure. For these years, the Department determined that Taxpayer was entitled to a refund of use tax. Taxpayer believes that it is entitled to additional refunds for those years, and filed this protest. Further facts will be supplied as required.

I. Use Tax—Overpayment.

DISCUSSION

Taxpayer protests the amount of refunds as determined by the Department for the years 2002, 2003, and 2004. Taxpayer believes that it is entitled to additional refunds for those years. The Department conducted an audit of use tax for those years and arrived at the amount of refunds. The amount of tax underpaid was added to the amount of tax overpaid. The Department did not audit Taxpayer's sales tax status. The use tax is imposed under IC § 6-2.5-3-2, which states in relevant part:

- (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.
- (b) The use tax is also imposed on the storage, use, or consumption of a vehicle, an aircraft, or a watercraft, if the vehicle, aircraft, or watercraft:
 - (1) is acquired in a transaction that is an isolated or occasional sale; and
 - (2) is required to be titled, licensed, or registered by this state for use in Indiana.
- (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; or
 - (2) the ultimate purchaser or recipient of that property would have been exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.
- (d) The use tax is imposed on a person who:
 - (1) manufactures, fabricates, or assembles tangible personal property from materials either within or outside Indiana; and
 - (2) uses, stores, distributes, or consumes tangible personal property in Indiana.
- (e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:
 - (1) the property is delivered into Indiana by or for the purchaser of the property;
 - (2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
 - (3) the property is subsequently transported out of state for use solely outside Indiana.

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Taxpayer protests that there are additional instances where it overpaid tax and fewer cases where it underpaid taxes than originally determined in the audit. Taxpayer states that, when taken together, these instances result in additional use tax refunds for these years.

The first category which Taxpayer protests is environmental compliance equipment. Taxpayer purchased a composite "paint" which was applied to the interior of a building which was used for environmental compliance purposes. The Department granted refunds of use tax on most of the items associated with this facility, but not on the paint. The Department determined that the paint only protected the exempt equipment, but was not required

itself for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards. Taxpayer states that the paint was used in direct compliance with environmental quality requirements. The relevant statute is IC § 6-2.5-5-30, which states:

Sales of tangible personal property are exempt from 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.

The portion of the sales price of tangible personal property which is exempt from state gross retail and use taxes under this section equals the product of: (A) the total sales price; multiplied by (B) one hundred percent (100[percent]).

The Department also referred to [45 IAC 2.2-5-70](#), which states:

(a) 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 environmental quality [sic.] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

(b) Definitions.

(1) Consumed as used in this regulation [\[45 IAC 2.2\]](#) 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 [\[45 IAC 2.2\]](#) means the material must be physically combined into and become a component of the environmental quality device, facility, or structure. The material must constitute [sic.] a material or integral part of the finished product.

(c) Portion exemption: The total sales price; multiplied by the percentage prescribed in the following table equals the portion of the sales price exempt from the state gross retail tax:

DATE OF SALE PERCENTAGE

- (1) After June 30, 1980 and before July 1, 1981 33 a%
- (2) After June 30, 1981 and before July 1, 1982 66 b%
- (3) After June 30, 1982 100%

The Department determined that the paint did not qualify for the environmental compliance exemption, since it protected the equipment which did qualify for the exemption. Taxpayer believes that the paint itself is required to comply with state, local, or federal environmental quality statutes, regulations, or standards. In the course of this protest, Taxpayer provided documentation supporting its position that the paint was required to comply with federal environmental regulations. The paint therefore qualifies for the exemption found at [45 IAC 2.2-5-70\(b\)\(2\)](#). Taxpayer also provided invoices for additional items which were used in environmental compliance, but which were not specifically addressed in the audit report. The documentation supplied is sufficient to establish that those items also qualify for the environmental compliance exemption.

Next, the Department determined that some of Taxpayer's capital asset purchases were used directly in the production process, and granted refunds on those items. The Department also determined that some of Taxpayer's capital asset purchases were not directly used in the production process, and did not grant refunds on those items. Taxpayer has provided additional documentation to support its claim that additional capital asset purchases were for items directly used in the direct production process. The relevant statute is IC § 6-2.5-5-3(b), which states:

Except as provided in subsection (c), 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.

The documentation supplied by Taxpayer supports its position regarding most of the items it claims are eligible for the exemption found at IC § 6-2.5-5-3(b), but not all of those items.

Some capital asset purchases listed on the schedule supplied by Taxpayer for summary and explanatory reasons do not have a corresponding invoice, and will therefore not be eligible for refund. Some items listed on the schedule are invoiced with dates in the year 2001, and are stamped by Taxpayer as "Entered" in early 2002. The tax years at issue in this protest are 2002, 2003, and 2004. The dates of invoice are the relevant dates, not the dates Taxpayer paid for the purchases, and therefore those items invoiced in 2001 will not be eligible for refund. Taxpayer has made no reference to any statute, regulation or court case which would require the Department to use the date Taxpayer paid for the purchase rather than the date of invoice.

Additionally, Taxpayer listed several invoices which were issued pursuant to lump sum contracts for improvement to realty. [Sales Tax Information Bulletin 60](#) (July 2006) explains in relevant part:

If a construction contractor purchases construction materials pursuant to a lump sum contract, the

construction contractor pays either: (1) sales tax at the time the construction materials are purchased, or (2) use tax at the time the construction materials are incorporated into real property if the contractor purchased or acquired the construction materials exempt from sales tax and the owner of the real property could not have purchased the materials exempt from sales tax.

There is no information in the protest file to indicate that contractors did not pay sales tax at the time of purchasing the materials incorporated into the realty in performance of the lump sum contracts. As explained in [Sales Tax Information Bulletin 60](#) (July 2006), the sales tax on the materials was paid at the time the contractor purchased them, and the remaining portion of the lump sum contracts were for labor services, which are not subject to use tax. Therefore, Taxpayer is correct that use tax should not be imposed on the invoices in these instances.

Taxpayer also included invoices for materials incorporated into concrete foundations for production equipment. The relevant exemption is found at [45 IAC 2.2-5-8](#), which states in relevant part:

- (a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.
- (b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.
- (c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

–EXAMPLES–

- (2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

(E) *A work bench used in conjunction with a work station or which supports production machinery within the production process.*

(*Emphasis added.*)

While most foundations are taxable, since the foundations in question specifically support production machinery in the production process, they qualify for the exemption found at [45 IAC 2.2-5-8\(c\)](#).

Next, due to the volume of purchases in question, and in agreement with Taxpayer, the Department conducted a statistical sample to determine use tax compliance for expense purchases. Taxpayer protests that several of these items were exempt from use tax for many of the same reasons as the capital asset purchases, including direct use in the production process and lump sum charges for improvements to realty, as well as charges for services and separately stated freight charges.

In this case, though, the Department and Taxpayer entered into an agreement to use a statistical sample. The Department used a sample of invoices in six strata to determine the percentages of exempt and non-exempt expense purchases. These percentages were applied to Taxpayer's overall purchases, and the result was the Department found that Taxpayer was due refunds of use tax. A review of the applicable exemptions and supporting documentation shows that the items do qualify for the appropriate exemptions.

Furthermore, one item included in strata 5 of the statistical sample stands apart from the other items. Taxpayer states that a loader used to move work in process is included in strata 5 as a taxable item and is included in the underpayment portion of the Department's calculations for strata 5 of the expense purchase statistical sample. Taxpayer also states that it erroneously paid sales tax when it purchased the loader, and that it therefore is due a refund of tax on that purchase in addition to revision of the calculations for strata 5. Example 4 of [45 IAC 2.2-5-8\(f\)](#) provides:

A forklift is used exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers. The forklift is taxable because it is used outside the integrated production process.

A review of the available documentation and Taxpayer's analysis shows that Taxpayer is incorrect that the loader is used to move work in process. As explained by Taxpayer, the loader is used to transport dust from an electric arc furnace area to be resold. While the furnace area is not a storage area, as referenced in Example 4, the "production" of the dust is complete when the loader picks it up. Therefore, the loader is used outside the integrated production process. The loader will not be added to the overpayment category of the calculations for strata 5. Still, the loader did have tax paid at the time of purchase. The loader will be removed from the

underpayment category of the calculations for strata 5 of the statistical sample.

Therefore, to the extent that the items referred to in this protest are included in the sample used to reach the percentages for exempt and non-exempt purchases, they will be used to recalculate the percentages of exempt and non-exempt purchases. Those percentages will then be applied to Taxpayer's overall purchases to arrive at new amounts of refund for these years.

In conclusion, Taxpayer is correct that it is due additional use tax refunds for the years at issue. There is sufficient documentation to support Taxpayer's position that its overpayments of tax were greater than originally determined, and that its underpayments of tax were less than originally determined. Due to the volume of invoices, a supplemental audit will be required to determine the amount of refund approved. As previously explained, any expense purchase items claimed in this protest must be one of the items included in the original statistical sample. As mentioned above, any item without supporting documentation will not be included in the refund calculations. Any item invoiced outside the audit period of 2002, 2003, and 2004 will not be included in the refund calculations. While this Letter of Findings has addressed some categories of the claimed items, the volume in question prohibits listing each item separately. All items listed in Taxpayer's protest materials are sustained for the reasons claimed by Taxpayer, unless specifically or categorically denied in the preceding text and subject to verification by supplemental audit.

FINDING

Taxpayer's protest is partially sustained, subject to supplemental audit.

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