DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 07-0458
Sales and Use Tax
For the Tax Years 2004-2005

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ISSUE

I. Sales and Use Tax–Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; IC § 6-8.1-5-4; 45 IAC 2.2-4-13; 45 IAC 2.2-5-8; *Indiana Dep't of Revenue v. Kimball Int'l Inc.,* 520 N.E.2d 454, 456 (Ind. Ct. App. 1988); *General Motors Corp. v. Indiana Dep't. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992).

Taxpayer protests the imposition of use tax on certain of its purchases.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation engaged in producing engine parts for trucks and cars. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed sales and use tax for the 2004 and 2005 tax years. The Department found that Taxpayer had made a variety of purchases without paying sales tax at the time of purchase and assessed use tax on the purchases. Taxpayer protested the assessment of use tax on certain of its purchases. A hearing was held, and this Letter of Findings results. Additional facts will be supplied as required.

I. Sales and Use Tax–Imposition.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had made a variety of purchases without paying sales tax at the time of purchase and assessed used tax on the purchases.

IC § 6-2.5-2-1 provides:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-3-2(a) provides:

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.

Accordingly, Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. Since Taxpayer failed to pay sales tax at the time of purchase, the Department found that the purchases were subject to use tax.

A. Natural Gas.

The Department found that Taxpayer had purchased natural gas without paying sales tax at the time of purchase and assessed use tax. The assessment was based upon Taxpayer's statements that all the natural gas was used to heat the building, as noted in the audit summary that was reviewed with Taxpayer.

In its protest, Taxpayer asserts that Taxpayer's use of the natural gas was exempt under the "utility production exemption" found in IC § 6-2.5-5-5.1.

IC § 6-2.5-5-5.1 provides:

(a) As used in this section, "tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat.

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing as described in IC § 6-2.1-2-4.

The Department refers to 45 IAC 2.2-4-13, provided in relevant part, which clarifies the "utility production exemption," as follows:

(a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to

consumers is subject to tax.

...

(c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5, based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.

(d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.

(e) Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50%) of the utility services and commodities are consumed for excepted uses.

Accordingly, for utility use to qualify for the "utility production exemption," the exempt use of the utility must be either (1) separately metered on the specific production equipment or (2) the predominant use of the utility.

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

During the course of the protest, Taxpayer submitted an exemption certificate and a self-conducted study of its natural gas usage for the 2007 tax year. Taxpayer asserts that this exemption certificate and study should be used to show that the gas usage for the audit period would meet the "utility production exemption" under the "predominate use" qualifications. However, the Department declines Taxpayer's invitation to use the 2007 tax year study. First, the exemption certificate and study report were provided without any source documentation. Second, the exemption certificate and study report the average monthly gas bill in 2007 to be $874, and during the 2004 and 2005 tax year, the years at issue, the average monthly gas bill was five times that amount (nearly $4,000 in 2004 and well over $4,000 in 2005). Lastly, the Department requested, but Taxpayer failed to provide the dates of acquisition, usage, and "discard" for all equipment using natural gas for the 2004, 2005, and 2007 tax years. Therefore, Taxpayer has failed to provide sufficient documentation to demonstrate that Taxpayer's natural gas usage qualifies for the "predominate use exemption."

Therefore, Taxpayer's protest is denied.

B. "Wire Baskets."

The Department found that Taxpayer had purchased "wire baskets" without paying sales tax at the time of purchase and assessed use tax on the purchases. Taxpayer purchased the "wire baskets" and sent the "wire baskets" to Taxpayer's sister plant, which manufactures "castings," to fill with "castings" to ship the "castings" to Taxpayer. Taxpayer then uses the "castings" as a raw material in its production of certain engines parts.

In its protest, Taxpayer asserts that Taxpayer's use of the "wire baskets" is exempt under 45 IAC 2.2-5-8(d) and 45 IAC 2.2-5-8(f)(3).

45 IAC 2.2-5-8(d) provides:

"Direct use in the production process" begins at the point of the first operation of activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form, including packing, if required.

45 IAC 2.2-5-8(f) provides:

(1) Tangible personal property used for moving raw materials to the plant *prior to their entrance into the production process is taxable.*

(2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.

(3) 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.

(4) Transportation equipment used to transport work-in-process, semi-finished, *or finished goods between plants is taxable, if the plants are not part of the same integrated production process*.

(*Emphasis Added*.)

Accordingly, since Taxpayer is transporting finished goods between plants, the Department refers to 45 IAC 2.2-5-8(f)(4), which provides that the finished goods are taxable unless the plants are "part of the same integrated production process."

Taxpayer supports it assertion of the exempt status by citing to *General Motors Corp. v. Indiana Dep't. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992).

In *General Motors*, the automobile manufacturer shipped component automobile parts to its plants and claimed an exemption for the purchase of items employed in the interdivisional transfer of those components parts. The court held that the automobile manufacturer's packing materials were part of the integral process

whereby the manufacturer produced its finished product. Therefore, the automobile manufacturer's packing materials were exempt under IC § 6-2.5-5-3. The court reached that decision after finding the automobile manufacturer's widely separated production facilities formed a cohesive, singular production unit in which the claimant's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." *General Motors*, 578 N.E.2d at 404.

In finding that the automobile manufacturer's production process encompassed manufacturing activities performed at multiple sites, the court identified a number of significant facts. Specifically, the court found that "[t]he facts in the case [FN3] as well as previous judicial findings [FN4] indicate GM's production process is by nature highly integrated. The court's sole concern, however, is whether GM's manufacturer of finished automobiles qualifies as one continuous integrated production process for the purpose of exemption from sales/use tax." *Id*. at 402.

Footnote three gives some indication of the evidence which the court relied in arriving at a conclusion that GM's production was both "continuous" and "integrated." Specifically, the court found that "GM's component plant personnel collaborate with the assembly plant personnel (1) to develop new product concepts, (2) to individually design, engineer, and test the performance of new parts and packing materials, (3) to plan the layout and production processes for new parts, (4) to coordinate production schedules because delays at one plant would have an immediate effect on the other plants, and (5) to solve problems and ensure quality control." *Id.* at n.3. In addition, the court noted that a "continuity of production exists between GM's different plants [which is] demonstrated by the standard practice of shifting certain production operations back and forth between component and assembly plants when necessary for more efficient operation." *Id.*

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of Revenue v. Kimball Int'l Inc.,* 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

In citing to *General Motors*, Taxpayer implies that *General Motors* allows for a blanket exemption to any and all tangible personal property used to transport anything between sister plants. However, Taxpayer is mistaken.

As provided above, it was in the context of those particularized facts and findings that the court held that GM's manufacture of automobiles represented one "continuous integrated production process." *Id.* at 404. It was in the context of those particularized facts and findings that the court held that GM's assembled automobiles, and not the automobile's component parts, constituted the taxpayer's most marketable product and that the production of that "most marketable product" constituted the conclusion of GM's integrated but physically discontinuous manufacturing process.

During the course of the protest, the Department requested, but Taxpayer failed to provide documentation detailing the specific facts that would analogize Taxpayer's situation to the facts and findings in *General Motors* detailing the highly integrated, continuous, indivisible, production process. In addition, Taxpayer did not cite any statute, regulation, or case law for the proposition that the Department was required to accept Taxpayer's assertions as to the time and nature of these transactions without providing the supporting documentation.

In fact, IC § 6-8.1-5-4(a) provides:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Pursuant to IC § 6-8.1-5-1(b), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer has failed to provide any documentation that demonstrates the "wire baskets" are used to move the castings *within* a highly integrated, continuous, indivisible, production process, Taxpayer has failed to meet its burden.

Therefore, Taxpayer's protest is denied.

C. "Guardrails and Wire Grating."

The Department found that Taxpayer had purchased various assets, which were listed under one asset project consisting mainly of "guardrails and wire grating," without paying sales tax at the time of purchase and assessed use tax.

At first, during the course of the protest, Taxpayer asserted that Taxpayer's use of the "guardrails and wire grating" was exempt under 45 2.2-5-8(c)(2)(f), which provides an exemption for "equipment which is required to allow a worker to participate in the production process without injury." Taxpayer was asked, but failed to provide documentation supporting its assertion.

However, later, during the course of the protest, Taxpayer asserted that the assets listed under this asset project did not consist of "guardrails and wire grating," but that ninety percent of the amount capitalized under this asset project was actually for "lift tables and platforms," which are exempt under 45 IAC 2.2-5-8(d) as used in the direct production process. During the course of the protest, the Department requested, but Taxpayer failed to provide invoices detailing the assets and amount paid for this asset project. In addition, Taxpayer did not cite any statute, regulation, or case law for the proposition that the Department was required to accept Taxpayer's

assertions as to the time and nature of these transactions without providing the supporting documentation.

In fact, IC § 6-8.1-5-4(a) provides:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Pursuant to IC § 6-8.1-5-1(b), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer has failed to provide any documentation demonstrating that the Department's assessment was incorrect, Taxpayer has failed to meet its burden.

Therefore, Taxpayer's protest is denied.

FINDING

In summary, Taxpayer's protests of subparts A, B, and C are denied.

CONCLUSION

Taxpayer's protest is denied.

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