

Letter of Findings Number: 08-0474
Sales and Use Tax
For the Tax Years 2005-2006

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ISSUE

I. Sales and Use Tax—Imposition.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-2.5-5-6; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-13](#); [45 IAC 2.2-5-14](#); Mid-America Energy Resources v. Dept. of State Revenue, 681 N.E.2d 259, 264 (Ind. Tax Ct. 1997); Indianapolis Fruit Co. v. Dept. of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer protests the assessment of use tax on its purchases of certain parts, supplies, and equipment.

STATEMENT OF FACTS

Taxpayer engages in the production of flowering and ornamental plants for sale. Taxpayer cultivates seeds and "rootless plant cuttings" into mature plants in the winter months outside the growing season using artificial temperature, light intensity, and humidity controls. Taxpayer sells its plants to wholesalers and/or retailers that sell the plants to the ultimate consumers. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional sales and use tax for the tax years 2005 and 2006. The Department found that Taxpayer had made a variety of purchases on which the Indiana sales tax was not paid at the time of purchase nor was use tax remitted to the Department. Taxpayer protests the imposition of use tax on certain purchases. An administrative hearing was held, and this Letter of Findings results. Further facts will be provided as necessary.

I. Sales and Use Tax—Imposition.

DISCUSSION

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

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). An exemption from the use tax is granted for transactions when 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 the purchase, the Department found that the purchases were subject to use tax.

Taxpayer maintains that as a producer or manufacturer of plants its purchases of certain items are used for production activities and are exempt under the "manufacturing exemptions" found in IC § 6-2.5-5-3 (the equipment exemption) and IC § 6-2.5-5-5.1 (the consumption exemption).

IC § 6-2.5-5-3(b) provides an exemption from sales tax for "manufacturing machinery, tools, and equipment... if the person acquiring the property acquires it for direct use in the direct production [or] manufacture... of other tangible personal property." Property acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "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 2.2-5-8\(c\)](#).

IC § 6-2.5-5-5.1(b) provides an exemption from sales 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... horticulture." In general, "[t]he state gross retail tax shall not apply to sales of tangible personal property as a material which is to be directly consumed in direct production by the purchaser in the business of producing... horticultural commodities." [45 IAC 2.2-5-13\(a\)](#). Property obtained for "direct consumption" is further defined in [45 IAC 2.2-5-13\(b\)](#) as "materials [that] are directly used in the production process" and have "an immediate effect upon the commodities 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 2.2-5-13\(b\)](#).

Accordingly, tangible personal property purchased for the direct use in the direct production of a manufactured good or for the direct consumption in the direct production of a horticultural good is subject to sales and use tax unless the property used has an immediate effect on and is essential to the production of the marketable good.

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 State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456

(Ind. Ct. App. 1988).

A. Greenhouse Parts and Materials.

Taxpayer asserts that its purchases of greenhouse parts and materials are directly used in and are an integral part of its plant production or manufacturing. Taxpayer maintains that the plants, in order to mature to its customers' specifications outside the growing season, must be cultivated in an artificial environment with specific temperatures, humidity levels, ventilation controls, and light intensity levels throughout the plants' growing stages. The greenhouse structure is highly complex with motorized and computerized equipment that self adjusts controlling the ventilation, temperature levels, light intensity levels, and humidity levels for the plants during the various stages of growth. Taxpayer contends that without the greenhouse the plants could not be grown because the plants are being grown during the winter months.

As used within the exemption statute, "production" is broadly defined and "focuses on the creation of a marketable good." *Mid-America Energy Resources v. Dept. of State Revenue*, 681 N.E.2d 259, 264 (Ind. Tax Ct. 1997). In *Indianapolis Fruit Co. v. Dept. of State Revenue*, 691 N.E.2d 1379 (Ind. Tax Ct. 1998), the court held that appellant taxpayer's equipment involved in the production of ripened bananas was entitled to the sales and use tax exemption. *Id.* at 1385. The court found that appellant taxpayer's introduction of ethylene gas into the banana ripening process was "sufficient to constitute production." *Id.* In contrast, the court held that appellant taxpayer's tomato ripening equipment was not entitled to the exemption because that particular ripening activity "was essentially passive in nature." *Id.* at 1386. The court summarized the distinction as follows: "With respect to the bananas, [taxpayer] actively induced the ripening; it did no such thing with respect to the tomatoes. In other words, the difference is that, with respect to the bananas, [taxpayer] made something happening; with respect to the tomatoes, [taxpayer] let something happen."

Taxpayer's production of products of plants is not complete until the most marketable product is achieved. That marketable product is not obtained until the individual products have reached the desired height and density to each of Taxpayer's customer's specifications before the start of the plants' natural growing seasons. Those particular qualities are not realized until the plants have been grown in a particular ventilation level, temperature level, light intensity level, and humidity level during the various stages of growth.

Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the following items are exempt under the "manufacturing exemptions":

- Gusset, "Tek Screws"; audit report p. 6, amount \$196.00
- Brackets; audit report p. 6, amount \$24.89
- Purlin Clamps; audit report p. 6, amount \$12.17
- Lockwire, Wirebase, Gablek, Hooks, and Frame; audit report p. 6, amount \$3,835.65
- 1) 4C440, 1) Bracket, audit report p.6, amount \$79.26
- Hardware for Greenhouse, audit report p.6, amount \$68.92
- Parts, audit report p.7, amount \$840.42
- Parts, audit report p.7, amount \$176.99
- Greenhouse Structure; audit report p. 7, amount \$12,732.00
- Hardware for Frame; audit report p. 7, amounts \$39.97
- Tube Motor, audit report p.6, amount \$439.19
- Flex Tubing, Air Transfer, audit report p.7, amount \$63.43
- Poly-Vent, Cut & Seal-PV, Air Transfer Gasket, audit report p.9, amount \$700.20
- Self-Retracting Neoprene/Polyester Duct, audit report p.9, amount \$108.75
- Parts, audit report p.9, amount \$27.73
- Parts, audit report p.9, amount \$244.68
- Greenhouse Structure; audit report p. 9, amount \$18,757.00

However, Taxpayer failed to provide documentation that demonstrates that the Department's assessment was incorrect for its purchase for "Mum Plumbing" (audit report p.7, amount \$145.19). Thus, Taxpayer has failed to meet its burden of proof under IC § 6-8.1-5-1(c), and Taxpayer's protest, as it relates to this item, is denied.

Therefore, Taxpayer's protest is sustained in part and denied in part.

B. Fertilizer Pump.

Taxpayer asserts the fertilizer pump (audit report p.6, amount \$473.11) is equipment that is directly used in and is an integral part of its plant manufacturing. Taxpayer maintains that the fertilizer pump draws a dry-concentrated fertilizer into the water line of the irrigation system to apply the fertilizer to the plants in a dilute form. The fertilizer pump has a mechanism that the Taxpayer sets for the pump to draw out the necessary ratio of fertilizer, in parts per million, to the amount of water for the specific number of plants in the greenhouse.

While the fertilizer pump may be a necessary part of Taxpayer's manufacturing system, the pump is not machinery that has an immediate effect on the plants. The pump simply functions to transport the fertilizer before it enters into the manufacturing process. Accordingly, the pump is a preproduction activity, which does not fall under the exemption.

Therefore, Taxpayer's protest is respectfully denied.

C. Generator.

Taxpayer asserts that the generator (audit report p. 6, amount \$1350.00) is equipment that is directly used in and is an integral part of its plant manufacturing. Taxpayer maintains that the generator is used in the greenhouse as an alternate power source when an electricity power outage occurs. If a power outage occurs, an alarm sounds in the greenhouse and Taxpayer turns on the generator to maintain the artificial environment necessary for the off-season plant maturity.

Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the generator is exempt to the extent that taxpayer's electric utilities are exempt.

Therefore, Taxpayer's protest is sustained.

D. "Seeds and Rootless Cuttings."

Taxpayer asserts that the greenhouse "seeds and rootless cuttings" (audit report p.6, amount \$75.82) are exempt under the "manufacturing exemptions." Taxpayer maintains that the "seeds and rootless cuttings" are manufactured and become the matured plants that Taxpayer sells.

IC § 6-2.5-5-6 provides an exemption from sales tax "if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures... for sale in his business." To qualify for this exemption, the property must be "incorporated by the purchaser as a material or integral part into tangible personal property produced for sale" in its manufacturing business. [45 IAC 2.2-5-14\(a\)](#).

Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the greenhouse "seeds and cuttings" are exempt.

Therefore, Taxpayer's protest is sustained.

E. "UPC Permit, UPC Labels, and Printer."

Taxpayer asserts that its purchases of a "uniform code council permit number" (audit report p.6, amount \$750.00), "thermal printer" (audit report p.9, amount \$3,464.82), and "polyprint labels" (audit report p.9, amount \$250.23) are part of its "UPC product labeling system" and qualify for the "manufacturing exemptions." The permit and printer are used to print the "UPC/bar-coded labels" that are affixed to the finished product. Taxpayer contends that its product is not finished until the "UPC/bar-coded label" is affixed because its customers will not purchase its product unless it contains a "UPC/bar-coded" label. Taxpayer maintains that the labels are incorporated as a material part of its product and are exempt under IC § 6-2.5-5-6, which provides an exemption from sales tax "if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures... for sale in his business."

Departmental regulation [45 IAC 2.2-5-14](#) states that in order to find that material is incorporated into the property produced for resale, "[t]he material must be physically incorporated into and become a component of the finished product, [t]he material must constitute a material or integral part of the finished product, and [t]he finished tangible personal property must be produced for sale by the purchaser." [45 IAC 2.2-5-14\(d\)](#).

Taxpayer's argument that its customers require the labels and therefore the labels become part of the product is not persuasive. While Taxpayer's labels may be required by its customers and an essential component within Taxpayer's marketing and distribution process, the labels do not become "material parts" of Taxpayer's products. The labels do not "constitute a material or integral part of the finished product." The labels are not essential to Taxpayer's finished product and do not affect the performance or utility of that finished product. The labels do not benefit the ultimate consumer. The labels are merely the ancillary means by which the Taxpayer's finished product find its way to the ultimate consumer. Thus, Taxpayer has not shown that the labels qualify for the "incorporation exemption" set out in IC § 6-2.5-5-6 and [45 IAC 2.2-5-14\(d\)\(2\)](#).

Taxpayer also asserts that the permit and printer used to print the labels are exempt pursuant to [IC 6-2.5-5-3\(b\)](#) because they are directly used in the direct production of the taxpayer's product. However, since the labels have been determined to not be part of the finished product, the permit and printer used in producing the labels do not impact the finished product. Thus, the permit and printer are not exempt.

Alternatively, Taxpayer asserts that the "uniform code council permit number" is not tangible personal property subject to sales and use tax, but is the right to use a "uniform code council permit number." However, Taxpayer has not provided any documentation to substantiate its claim to the nature of the transaction in question. 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 nature of the transaction without providing the supporting documentation. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed 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 nature of the transaction, Taxpayer has failed to meet its burden.

Therefore, Taxpayer's protest is respectfully denied.

F. "Fluorescent Work Lights."

Taxpayer asserts that the "fluorescent work lights" (audit report p.6, amount \$2286.73) are equipment that is directly used in and is an integral part of its plant manufacturing. Taxpayer maintains that the lights are a necessary light source in the potting area.

While the "fluorescent work lights" may be a necessary part of Taxpayer's business operations, the "fluorescent work lights" are not machinery that has an immediate effect on the plants. The fluorescent work lights simply function to provide a source of light for general illumination of the potting area.

Therefore, Taxpayer's protest is respectfully denied.

G. Tank.

Taxpayer asserts that the "tank" (audit report p. 9, amount \$2,267.37) is equipment that is directly used in and is an integral part of its plant manufacturing. Taxpayer maintains that tank is part of its propane heating system that is used in the greenhouse to maintain the artificial temperature and humidity controls for off-season plant maturity.

Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the tank is exempt to the extent that taxpayer's propane heating system is exempt.

Therefore, Taxpayer's protest is sustained.

H. Irrigation System.

Taxpayer asserts that the "main lines, lateral lines, and pot drops" (audit report p.7, amount \$2,000.00) are equipment that is directly use in and are an integral part of its plant manufacturing as part of its irrigation system. Taxpayer maintains that the "lines" are part of its irrigation system that provides water directly to the plants. The "main lines" and "lateral lines" connect the water source to the "pot drops," which distribute the water to the individual plants.

While the irrigation system may be a necessary part of Taxpayer's manufacturing system, the irrigation system is not machinery that has an immediate effect on the plants. The irrigation system simply functions to transport water before it enters into the manufacturing process. Accordingly, the irrigation system is a preproduction activity, which does not fall under the exemption.

Therefore, Taxpayer's protest is respectfully denied.

I. "6' by 250' Mat."

Taxpayer asserts that the "6' by 250' mat" (audit report p.6, amount \$267.00) is equipment that is directly used in and are an integral part of its plant manufacturing. Taxpayer maintains that the mat is placed on the greenhouse floor to keep weeds from growing and contaminating the greenhouse with unwanted bugs or weed seeds. Taxpayer explains that its plants for sale could not grow as well if the bugs or weeds contaminated the pots where its plants were growing.

While the "6' by 250' mat" may be a necessary part of Taxpayer's manufacturing system, the "6' by 250' mat" is not machinery that has an immediate effect on the plants. The irrigation system simply functions to as a general environmental control. Accordingly, the "6' by 250' mat" is too far removed from the production process and does not fall under the exemption.

Therefore, Taxpayer's protest is denied.

J. Pesticides.

Taxpayer asserts that the pesticides (invoices 57328 and 57522, audit report p.9, amounts \$190.00 and \$284.00) are property that is directly consumption in the direct production of horticulture goods. Taxpayer maintains that the pesticides are sprayed directly on the plants during production to keep weeds and bugs from contaminating or damaging the plants. Taxpayer explains that its plants for sale could not grow as well if the bugs or weeds contaminated the plants.

Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the pesticides are exempt to the extent that the pesticides are applied directly to the plants during production.

Therefore, Taxpayer's protest is sustained.

K. "Electric Atom Mist Sprayer" and "breathing apparatus."

Taxpayer asserts that the "electric atom mist sprayer" and "breathing apparatus" (invoice 57583, audit report p.9, amount \$178.25) are used to spray highly toxic, restricted use pesticides directly on the plants during production. The pesticide must be applied by spraying to protect the employee from the touching the highly toxic pesticide. A breathing apparatus must be worn to protect the employee from breathing any fumes. After spraying the plants with the pesticides, no one can enter the greenhouse for twelve hours because it is toxic to the skin, eyes, and lungs.

[45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#) provides for an exemption for "safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production."

Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the "electric atom mist sprayer" and breathing apparatus are exempt "safety equipment."

Therefore, Taxpayer's protest is sustained.

FINDING

In summary, Taxpayer's protest of subpart A is sustained in part and denied in part. Taxpayer's protest of subpart A is denied for its purchase for "Mum Plumbing" and is sustained for all the other items listed in subpart A. Taxpayer's protest of subparts B, E, F, H, and I are denied. Taxpayer's protest of subparts C, D, G, J and K are sustained.

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