

**Letter of Findings: 08-0014
Sales Tax
For Tax Years 2004-07**

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ISSUE

I. Sales Tax—Utilities Exemption.

Authority: IC § 6-2.5-4-5; IC § 6-2.5-5-1; IC § 6-8.1-5-1; [45 IAC 2.2-4-13](#).

Taxpayer protests the denial of refund of and imposition of additional tax on a portion of sales tax relating to utilities.

STATEMENT OF FACTS

Taxpayer is a business in the commercial baked goods industry in Indiana. When Taxpayer filed a claim for refund of one hundred percent of sales tax on electric usage for the tax years 2004 through 2007, the Indiana Department of Revenue ("Department") initially approved of and issued a refund for one hundred percent exemption on electric usage. The Department then conducted a further investigation of the claim. As a result of the investigation, the Department reduced the exemption percentage and issued assessments to recover the amount of sales tax it believed had been incorrectly refunded. Taxpayer protests the assessments and also protests that the Department misunderstood the nature of its use of some utilities and therefore was entitled to the predominant use exemption for utilities. An administrative hearing was held and further documentation and analysis was provided and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax—Utilities Exemption.

DISCUSSION

Taxpayer protests the Department's determination of the exemption percentage of its utility usage. The Department based its determination on its observation of the use of the equipment, including the freezer, in Taxpayer's factory. The Department noted that the freezer is used to freeze some products as part of the production process and granted a two percent exemption to the freezer. Taxpayer protests that the Department misunderstood the use of the freezer and that the freezer is used predominantly for production of its goods. Taxpayer asserts that, when the proper percentage of exempt use of electricity by the freezer is taken into account, its overall percentage of electric usage is over fifty percent and therefore it is entitled to the predominant use exemption. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department based its determination of the exemption percentage on the observed use of the equipment and on a utility study prepared by the Department. The relevant statute is IC § 6-2.5-5-1, which states:

(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, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

Taxpayer protests that it is entitled to the predominant use exemption found at IC § 6-2.5-4-5(c)(3), which states:

c) Notwithstanding subsection (b), a power subsidiary or a person engaged as a public utility is not a retail merchant making a retail transaction in any of the following transactions:

...

(3) The power subsidiary or person sells the services or commodities listed in subsection (b) to a person for use in manufacturing, mining, production, refining, oil extraction, mineral extraction, irrigation, agriculture, or horticulture. However, this exclusion for sales of the services and commodities only applies if the services are consumed as an essential and integral part of an integrated process that produces tangible personal property and those sales are separately metered for the excepted uses listed in this subdivision, or if those sales are not separately metered but are predominately used by the purchaser for the excepted uses listed in this subdivision.

Also, [45 IAC 2.2-4-13](#) explains:

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

(b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling

electrical energy gas, water, or steam to consumers for direct use in direct 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](#) shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under [IC 6-2.5-5-5.1](#).

(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[percent]) of the utility services and commodities are consumed for excepted uses.

(Emphasis added.)

The Department considered Taxpayer's freezer to be primarily post-production equipment and therefore primarily not exempt. The freezer is also used to store some product after it is frozen and it is waiting to be shipped to Taxpayer's customers. Taxpayer protests that the freezer is used to freeze its products as part of the production process. As part of the protest process, Taxpayer provided sufficient documentation to establish that it primarily sells frozen baked goods to grocery stores in Indiana and several other states. The grocers do not accept fresh or merely refrigerated goods. Therefore, the goods must be frozen as part of the production process. Taxpayer's product is primarily frozen baked goods, and the freezer is therefore primarily used in the production process.

Therefore, the freezer is used in the production process when freezing baked goods and when used to chill items as part of the production process. The freezer is also used to store items after they are frozen, which takes place after the production process is completed. Taxpayer provided documentation which explains the power draw of the freezer for different purposes. The freezing of baked goods takes a great deal more electric power than the maintenance of frozen products at the appropriate temperature. The records available to the Department indicate that an exemption rate of ninety percent is appropriate for the freezer. A supplemental audit will recalculate Taxpayer's overall exempt usage using the ninety percent exemption rate for the freezer. If the overall exemption rate is over fifty percent, Taxpayer will qualify for the predominant use exemption provided by IC § 6-2.5-4-5(c)(3). If the overall exemption rate is less than fifty percent, Taxpayer will be subject to the new exemption rate. The supplemental audit will redetermine the amount of refund or liability due.

FINDING

Taxpayer is sustained, subject to the results of a supplemental audit.

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