

Letter of Findings: 09-0220
Gross Retail Tax
For the Years 2005, 2006, and 2007

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ISSUE

I. Restaurant Utility Exemption – Sales/Use Tax.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-4-5(b); IC § 6-2.5-4-5(c); IC § 6-2.5-4-5(c)(3); IC § 6-2.5-5-1 et seq.; [45 IAC 2.2-4-13\(e\)](#).

Taxpayer argues that it is entitled to the "predominate usage" sales tax exemption.

STATEMENT OF FACTS

Taxpayer is an Indiana business which operates fast-food restaurants. The Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. At one of the locations, the Department found that the particular restaurant had been paying insufficient sales tax on the purchase of electricity. Accordingly, the audit assessed additional sales tax on that portion of the electricity which was not directly consumed in food preparation. At that particular location, the audit found that forty-eight percent of the electricity was used to prepare food and assessed additional sales tax on the remaining fifty-two percent of electrical consumption which had not been previously paid.

The audit also reviewed the utility usage at three other restaurant locations. At those three particular locations, the audit found that slightly more than fifty percent of the electricity purchased was used to prepare food; therefore, taxpayer was allowed the "predominate use" exemption and was granted a refund of all sales tax paid on the locations' purchase of electricity. Insofar as these "three other restaurant locations," taxpayer naturally has no objection to the audit's conclusions.

At five other locations, the Department found that taxpayer had been paying sales tax on all purchases of electricity, calculated the amount of electricity directly consumed in preparing food, and refunded sales tax attributable to the purchase of exempt electricity.

In varying amounts, taxpayer received refund checks attributable to the purchase of electricity which had been used in an exempt manner. Nonetheless, taxpayer objected arguing that at the "five other locations," it was entitled to the "predominate use" exemption and at the first location – which had underpaid sales tax – the assessment of tax was unwarranted because that location was also entitled to the "predominate use" exemption. In effect, taxpayer seeks to avoid the assessment at the first store location and then to obtain a total refund of sales tax attributable to the "five other locations."

I. Restaurant Utility Exemption – Sales/Use Tax.

DISCUSSION

Taxpayer believes that it can substantiate the proposition that six of its restaurant locations (the "five other locations" and the one restaurant which was assessed additional sales tax) use more than fifty percent of their electricity in an exempt fashion. Therefore, according to taxpayer, it is entitled to a refund of all the sales tax paid on the purchase of electricity.

Indiana imposes a gross retail (sales) tax on certain sales made within the state. IC § 6-2.5-2-1(a). The tax is not imposed on all transactions but only those which constitute "retail transactions."

Sales of public utilities are specifically designated as "retail transactions." IC § 6-2.5-4-5(b) states that, "A power subsidiary or a person engaged as a public utility is a retail merchant making a retail transaction when the subsidiary or person furnishes or sells electrical energy, natural or artificial gas, water, steam, or steam heating service to a person for commercial or domestic consumption." (Emphasis added). Therefore, when the electric utility sold electricity to taxpayer's restaurants, it was required to collect sales tax.

However, the legislature has seen fit to allow a number of specific sales tax exclusions. See IC § 6-2.5-5-1 et seq. The statute, designating utility transactions as "retail sales," refers to one of those exclusions. IC § 6-2.5-4-5(c) states:

Notwithstanding subsection (b), a power subsidiary or a person engaged as a public utility is not a retail merchant making a retail transaction when... (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. (Emphasis added).

Therefore, if a restaurant purchases electricity to operate an oven which is "directly" used to produce food

products, it is entitled to claim the sales tax exemption as long as there is a means of directly measuring (i.e. "metering") the electricity used by that particular oven. However, taxpayer does not meter its utility usage in a manner which permits a direct correlation between the consumption of the utility services and the production of taxpayer's food products. Instead taxpayer relies on the language contained with IC § 6-2.5-4-5(c)(3). That language permits a manufacturer of tangible personal property to claim the utility exemption "if those [utility] sales are not separately metered but are predominately used by the purchaser for the excepted uses listed in this subdivision." (Emphasis added). Therefore in order for taxpayer to claim a total refund of all sales tax paid on the purchase of electricity, taxpayer must demonstrate that the electricity purchased is "predominately used" to manufacture its food products.

The Department has defined "predominantly used" as follows:

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 predominantly used for excepted purposes. Predominant use shall mean that more than fifty percent (50 [percent]) of such utility services are consumed for excepted use. [45 IAC 2.2-4-13\(e\)](#).

At the one restaurant for which additional sales tax was assessed, the audit prepared a "utility study" which considered the exempt equipment and calculated that equipment's annual kilowatt usage. For example, the audit classified a "coffee maker" as exempt, determined the amount of electricity consumed by the device, noted the amount of hours it was in operation, calculated a "load factor," and determined the hours the coffee maker was used each day along with the number of days that the restaurant was operated during the year. After considering all items of production equipment, taxpayer compared the total annual consumption of electricity to the amount of electricity used by the exempt equipment. The audit concluded that forty-eight percent of the electricity was used in an exempt manner and fifty-two percent was used in a non-exempt fashion such as air conditioning. Taxpayer objects arguing that a subsequent increase in the "load factor," attributable to a substantial increase in sales, warrants a conclusion that more than fifty-two percent of the electricity is used in an exempt fashion. Taxpayer essentially argued that because the sales at this particular store increased, the consumption of exempt electricity increased in a manner disproportion to overall consumption. As stated by taxpayer, "Increase in sales Volumes over base stores already fully exempt primarily impact Production Equipment Usage."

Taxpayer presents an interesting theory, and this theory has a certain common sense but nonetheless speculative appeal. In order to prevail, taxpayer is required to present evidence sufficient to refute the conclusions of the auditor who conducted the on-site investigation, reviewed the equipment at each store, performed the necessary calculations, and who was in the best position to arrive at a reasonable judgment at the time the audit review was conducted. Given the increase in sales volume at each store, it is possible that the amount of non-exempt electrical consumption increased disproportionately to overall consumption; the restaurant necessarily "produced" additional food but its non-exempt consumption also necessarily increased. Taxpayer has failed to meet its burden of providing the evidence necessary to substantiate its argument. The Department is unwilling to second-guess the audit which – under similar circumstances – agreed with taxpayer that three of the restaurant locations were entitled to the "predominate usage" exemption.

Taxpayer's request for additional refunds deriving from the "five other locations" is based on the same taxpayer argument. According to Taxpayer, because the amount of sales volume at those five locations increased, then the natural increase in electrical consumption in those stores is primarily and disproportionately attributable to exempt production equipment. The Department must decline the opportunity to accept the theory. The original audit was well documented, well supported, and the results essentially unrefuted [*sic*].

FINDING

Taxpayer's protest is respectfully denied.

Posted: 07/29/2009 by Legislative Services Agency
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