DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 09-0364
Sales and Use Tax
For the Tax Years 2006 and 2007

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ISSUES

I. Sales and Use Tax–"Manufacturing Equipment."

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 § 6-2.5-5-3; IC § 6-8.1-5-1; 45 IAC 2.2-5-6; 45 IAC 2.2-5-8; Rotation Prods. Corp. v. Dep't of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998); Indiana Waste Sys. v. Indiana Dep't of State Revenue, 633 N.E.2d 359 (Ind. Tax Ct. 1994); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer protests the imposition of use tax on certain equipment.

STATEMENT OF FACTS

Taxpayer sells fertilizer, agricultural chemicals, seeds, and other farming supplies. Taxpayer also provides soil testing services and services applying chemicals and/or fertilizers to its customers' fields. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax, interest, and penalty for the 2006 and 2007 tax years. The Department found that Taxpayer had made a variety of purchases without paying sales tax at the time of purchase or remitting use tax to the Department. Taxpayer protested the imposition of use tax on its purchases of certain equipment. An administrative hearing was held, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Sales and Use Tax–"Manufacturing Equipment."

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.

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 treated seeds and chemical fertilizers its purchases of certain items are used for production activities and are exempt under the "manufacturing equipment exemption" found in IC § 6-2.5-5-3.

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." Id.

Accordingly, tangible personal property purchased for the direct use in the direct production of a manufactured 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. Additionally, 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. Conveyor and Pump.

Taxpayer asserts that the conveyor and pump are directly used in and are an integral part of its seed treating production process. Taxpayer maintains that the conveyor moves the seeds from the raw materials storage containers to the hopper, which is where the seeds are coated/treated with herbicides and/or insecticides. The pump is used to draw the liquid herbicide and/or insecticide from the respective raw materials storage containers into the hopper.

While the conveyor and pump may be a necessary part of Taxpayer's seed treating system, the conveyor and pump are not machinery that has an immediate effect on the seeds. During the time the raw materials are on the conveyor or in the pump, the raw materials are not being mixed, altered, combined, or changed in form. The conveyor and pump simply function to transport the raw materials before the materials enter into the

manufacturing process. Accordingly, the conveyor and pump are used in preproduction activities, which do not fall under the exemption.

Therefore, Taxpayer's protest to the imposition of use tax on its conveyor and pump is respectfully denied.

B. "30K Gallon Tanks."

Taxpayer asserts that the mixing tanks are directly used in and are an integral part of its chemical fertilizer production process. Taxpayer maintains that the tanks are equipped with plumbing and air lines that are used in the chemical mixing process.

Taxpayer receives the nitrogen product in a "32 percent solution," which it converts into one of two products–a "28 percent solution" or a "16-16-0 solution." The nitrogen is pumped from a rail car into the 30K tanks. The tanks are equipped with plumbing and air lines that are used to mix the specific amounts of water and phosphorus into the "32 percent nitrogen solution" to create either the "28 percent solution" or the "16-16-0 solution." The "3 percent nitrogen solution," which has too high of a salt content and lacks phosphorus, is unmarketable because it would actually kill the plants. The nitrogen solution must be processed into the other solutions to be used as a chemical fertilizer.

Taxpayer uses the tanks to process the "32 percent nitrogen solution" into marketable products. During the time the raw materials are in the tanks, the raw materials are mixed, altered, combined, and changed in form into a marketable good. Thus, the tanks are used within the production process and have an immediate effect on the good being produced. Pursuant to IC § 6-8.1-5-1(c), taxpayer has met its burden of demonstrating that the "30K gallon tanks" are exempt under the manufacturing exemption.

Therefore, Taxpayer's protest to the imposition of use tax on its "30K gallon tanks" is sustained.

C. Trailer and Wagon.

Taxpayer asserts that since it purchased the trailer and the wagon to deliver seeds and chemicals to its customers' fields, the trailer and the wagon purchases are exempt agricultural equipment under IC § 6-2.5-5-3(b). Taxpayer supports its assertion by citing to 45 IAC 2.2-5-6(d)(9).

As a general rule, "all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable." 45 IAC 2.2-5-6(a). Moreover, IC § 6-2.5-5-3(b) requires that the equipment in question be used "in the direct production... of other tangible personal property." (Emphasis added).

In Rotation Prods. Corp. v. Dep't of State Revenue, 690 N.E.2d 795, 800 (Ind. Tax Ct. 1998), the tax court explained, "When goods are not produced, and a service is provided, the [manufacturing] exemptions are properly denied." Id. Additionally, in Indiana Waste Sys. v. Indiana Dep't of State Revenue, 633 N.E.2d 359, 363 (Ind. Tax Ct. 1994), the tax court further expounded on the "equipment exemption" providing that it is not enough that a taxpayer seeking to claim the equipment exemption acts as one part of a larger overall process that results in the production of tangible personal property. Id. The tax court found that the tangible personal property must be produced "as part of [the taxpayer's] own process... not as part of an alleged process of another taxpayer." Id. The tax court established a "minimum threshold requirement... that the taxpayer who purchases the equipment in question be the entity that uses the equipment 'for his direct use in the direct production... of other tangible personal property.' IC 6-2.5-5-3(b)." Id. at 362-63 (emphasis in original). Thus, the tax court determined that in order "to have a colorable claim for the equipment exemption" pursuant to IC § 6-2.5-5-3(b), a taxpayer must use the equipment "as part of its own process to produce other tangible personal property, not as part of an alleged process of another taxpayer." Id.

In the case at hand, Taxpayer uses the trailer and the wagon to deliver products to its customers, which are farmers that produce agricultural commodities. As such, Taxpayer itself does not produce the agricultural commodities. Since the use of the trailer and the wagon does not meet the requirement that the production equipment cannot be used "as part of an alleged process of another taxpayer," Taxpayer's purchases do not meet the exemption found in IC § 6-2.5-5-3(b).

Therefore, Taxpayer's protest to the imposition of use tax on its trailer and wagon is respectfully denied.

FINDING

In summary, Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest is sustained for Issue I(B), and Taxpayer's protest is denied for Issue I(A) and I(C).

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