

Letter of Findings Number: 09-0457
Use Tax
For Tax Years 2005-07

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ISSUES

I. Use Tax—Manufacturing Exemption.

Authority: IC § 6-2.5-1-5; IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-2.5-5-9; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-4-2](#); [45 IAC 2.2-4-3](#); [45 IAC 2.2-4-21](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-4-23](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10](#); [45 IAC 2.2-5-12](#); [45 IAC 2.2-5-16](#).

Taxpayer protests the imposition of use tax on some items included as taxable in the audit.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a steel processor in Indiana. The Indiana Department of Revenue ("Department") audited Taxpayer for the tax years 2005, 2006, and 2007. Due to the large amount of invoices, the Department and Taxpayer agreed to use a sample and projection method to perform the audit. The Department determined that Taxpayer had not paid sales tax on certain taxable purchases. The Department issued proposed assessments for use tax, negligence penalties, and interest for those years. Taxpayer protests the imposition of use tax on some of the items included as taxable, as well as a calculation error in the projection. Taxpayer states that these protested items are exempt for several reasons. Taxpayer also protests the imposition of ten percent negligence penalty for the years at issue. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Manufacturing Exemption.

DISCUSSION

Taxpayer protests the inclusion of several items listed as taxable in the Department's audit for the tax years 2005, 2006, and 2007. Taxpayer states that the items it is protesting are used in its manufacturing process and are therefore exempt under the manufacturing 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 use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) 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.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

The manufacturing exemption is found at IC § 6-2.5-5-3, which states:

(a) For purposes of this section:

(1) the retreading of tires shall be treated as the processing of tangible personal property; and

(2) commercial printing shall be treated as the production and manufacture of tangible personal property.

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.

(Emphasis added.)

Also, [45 IAC 2.2-5-8](#) provides in part:

(a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

(b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

....

Taxpayer states that it is in the manufacturing business and that some of the items included in the Department's listing of taxable items were used in its manufacturing operations. Therefore, Taxpayer believes that those items qualify for the exemption provided under IC § 6-2.5-5-3(b).

Protest category one consists of parts related to an uncoiler used to uncoil rolls of steel which Taxpayer then processes. The Department determined that the uncoiler was part of the pre-production process and that the manufacturing process did not start until the uncoiled steel was leveled. Taxpayer protests that the uncoiler was an integral part of an integrated process which started with "pickling" the coils to restore malleability and remove contaminants. This consists of uncoiling, pickling, and recoiling on a take up reel. The coils are then moved to other production steps, which involve uncoilers as well.

A review of the materials provided in the hearing process establishes that the uncoiler in question is used in the production process. Taxpayer included several exhibits with its protest letter. The items listed in Taxpayer's "Exhibit One" were used as repair parts on the uncoiler and are therefore exempt as provided by IC § 6-2.5-5-3(b).

However, a review of the items listed in Exhibit One shows that two of the items do not qualify for exemption. The first item appears to be a repetition of a previously listed item. Exhibit One lists "Wedge Tops" for the uncoiler, from Taxpayer's account number 3550, at a price of \$1,375.00, twice. A review of the audit report shows only one entry for "Wedge Tops" at \$1,375.00. The second item is, from Taxpayer's account number 3444, uncoiler support arms at \$5,200.00. A review of the audit report does not show an entry for uncoiler support arms at \$5,200.00. Therefore, the first item is only listed once in the audit report and can only be removed once. Also, the second item is not listed in the audit report and cannot be removed. A supplemental audit will review the audit report to verify the presence or absence of two wedge top entries and an uncoiler support arms entry.

Protest category two consists of invoices from contractors. Taxpayer states that the audit report includes several of these invoices for jobs performed by the contractors for Taxpayer. Taxpayer refers to [45 IAC 2.2-4-23](#), which states:

A contractor has no further liability for either the state gross retail tax or use tax with respect to construction material acquired by the contractor in a taxable transaction, provided the contractor disposes of such property in the following manner:

- (1) He converts the construction materials into realty on land he owns and then sells the improved real estate;
- (2) He utilizes the construction material for his own benefit and does not resell or transfer such property to others; or
- (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

(Emphasis added).

Also of relevance is [45 IAC 2.2-4-21](#), which states:

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [[45 IAC 2.2-5](#)]).

(Emphasis added).

Also, [45 IAC 2.2-4-22](#) states:

(a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.

(b) A contractor, who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material "tax-free", is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [[45 IAC 2.2-5](#)]).

(c) A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired "taxfree", is not subject to either the state gross retail tax or use tax upon disposition.

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to

collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

- (1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax); or
 - (2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.
- (e) Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:
- (1) He converts the construction material into realty on land he owns and then sells the improved real estate;
 - (2) He utilizes the construction material for his own benefit; or
 - (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

A disposition under C. [subsection (e)(3) of this section] will be exempt from the use tax if the contractor received a valid exemption certificate from the ultimate purchaser (purchaser) or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

Therefore, tangible personal property ("TPP") supplied in the course of construction is taxable to either the contractor or the contractor's client if the contractor does not pay sales tax on the TPP and if the client is not exempt. A review of the documentation supplied in the hearing process shows that the contractors did charge lump sums for the jobs in question and that the sales tax was paid by the contractor at the time of purchase.

Protest category three consists of a down payment on a rotary shear machine. Taxpayer protests that this item is used directly in the manufacturing process and is therefore exempt under IC § 6-2.5-5-3(b). Upon review of the protest file, Taxpayer is correct and the rotary shear machine is exempt from sales and use tax. Also, there is correspondence between Taxpayer and the auditor which indicate that the auditor agreed with this position and intended to remove this entry from the audit report. A supplemental audit will verify that the down payment on the rotary shear machine is removed from the audit.

Protest category four consists of parts and tools used in the construction of a new annealing line. In the annealing process, Taxpayer takes steel coils and subjects them to a process which results in cleaner, coated coils of steel. These are substantially different than uncoated coils and are "manufactured." Therefore, under IC § 6-2.5-5-3(b), these items are exempt.

Taxpayer also protests the imposition of use tax on the rental of tanks which hold various gasses such as hydrogen and nitrogen which are used in the annealing process. Taxpayer states that these gasses are used in the manufacturing process and that the tanks are therefore required to conduct manufacturing. Taxpayer refers to [45 IAC 2.2-5-8\(e\)\(3\)](#), which states:

Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax.

Taxpayer believes that this means that the gas storage tanks are exempt. The Department refers to [45 IAC 2.2-5-10\(d\)](#), which states:

"Direct use" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.

Therefore, direct use begins at the point when the gasses are introduced into the annealing process. The tanks in question store the gasses prior to introduction into the production process. Unlike the storage facilities or containers described in [45 IAC 2.2-5-8\(e\)\(3\)](#), these tanks store gas prior to the production process as defined by [45 IAC 2.2-5-10\(d\)](#). Therefore, the tanks are taxable.

Protest category five consists of banding and wrapping equipment. Taxpayer states that the production process is not complete until the coils are banded and wrapped and the equipment therefore qualifies as manufacturing equipment and is exempt. Taxpayer lists several safety reasons why the coils must be banded and wrapped. IC § 6-2.5-5-9 provides:

- (a) As used in this section, "returnable containers" means containers customarily returned by the buyer of the contents for reuse as containers.
- (b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in [IC 6-2.5-4-1](#) and if the returnable containers contain contents.
- (c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.
- (d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person

acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.

(Emphasis added).

Also, [45 IAC 2.2-5-16](#) provides in relevant parts:

(a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

...

(c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:

(1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.

....

(Emphasis added).

Therefore, strapping and wrapping materials are exempt from sales and use tax. That exemption does not require the strapping and wrapping materials be part of the manufacturing process. Those materials are exempt on a basis independent from the manufacturing process. However, what is being protested here is use tax on the strapping and wrapping equipment, not the materials. While the steel coils undoubtedly must remain coiled for many reasons, the banding and wrapping is not what Taxpayer is selling. The steel itself is what is sold, and the manufacturing process ends when the steel itself reaches its final form. The banding and wrapping take place after the manufacturing process is completed. The banding and wrapping equipment are not part of the manufacturing process and are therefore not exempt.

Protest category six consists of production equipment repair parts and tools. The relevant regulation is [45 IAC 2.2-5-8](#)(h), which states:

(1) Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

(2) Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax.

–EXAMPLE–

A manufacturer of sheet metal repairs and upgrades used machinery by replacing worn or broken parts and adding new elements and features available in state-of-the-art equipment. All items which become components of the upgraded machinery are exempt from tax. However, all tools and equipment used to repair or upgrade used machinery would be taxable.

Taxpayer states that all of the items listed in its exhibit six are either replacement parts for, or tools used to maintain, exempt equipment. One item is a scrap winder, used to wind a continuous, narrow piece of sheet metal which has been trimmed from the main coil. Taxpayer explains that this scrap is sold as a marketable item in its own right. However, any effort which went into the manufacture of the scrap was finished prior to its winding on this piece of equipment. Also, exhibit six lists an adjustable head hook style spanner wrench. As provided by [45 IAC 2.2-5-8](#)(h)(1), tools used to repair and maintain exempt production machinery are subject to tax. Therefore, the scrap winder and adjustable head hook style spanner wrench are subject to tax. The remaining items are exempt under [45 IAC 2.2-5-8](#)(h).

Protest category seven consists of testing and inspection tools and equipment. Taxpayer refers to [45 IAC 2.2-5-8](#)(i), which states:

Machinery, tools, and equipment used to test and inspect the product as part of the production process are exempt.

–EXAMPLE–

Selected parts are removed from production according to a schedule dictated by statistical sampling methods. Quality control equipment is used to test the parts in a room in the plant separate from the production line. Because of the functional interrelationship between the testing equipment and the machinery on the production line and because of the product flow, the testing equipment is an integral part of the integrated production process and is exempt.

Taxpayer provided sufficient documentation to establish that the equipment in question is used for testing and inspection as part of the production process.

Protest category eight consists of chains for an overhead crane. In the course of the audit, the Department and Taxpayer agreed that the overhead crane was forty (40) percent taxable and sixty (60) percent exempt. In the audit report, the chain for the crane was treated as one hundred (100) percent taxable. A review of the audit report confirms that the agreed rate was forty percent. Since the chain is an integral part of the overhead crane, the forty percent taxable rate will be applied to the chain.

Protest category nine consists of a charge for services. Taxpayer refers to [45 IAC 2.2-4-2](#), which states in relevant part:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Taxpayer protests that the charge listed in the audit report is from a software company hired to program software and to assist with data extrapolation. A review of the audit report shows that the listed invoice was for labor involved in data transfers. There was no tangible personal property transferred, as required by [45 IAC 2.2-4-2\(a\)](#), and the charge was for services only. Therefore, use tax is not due on this item.

Protest category ten consists of software which Taxpayer states is used in the production process. Taxpayer refers to [45 IAC 2.2-5-8\(g\)](#), which states in relevant part:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

–EXAMPLES–

...

(6) Computers which are interconnected with and control other production machinery or are used to make tapes which control computerized production machinery are exempt from tax.

....

Taxpayer has provided sufficient documentation to establish that the software is an integral component of a manufacturing unit. Therefore, the software is exempt as provided by example six of [45 IAC 2.2-5-8\(g\)](#).

Protest category eleven consists of a freight charge on the delivery to Taxpayer of steel banding which Taxpayer used to secure steel coils for shipping. As discussed above, the banding is exempt from sales and use tax. Taxpayer states that, since the banding was exempt, that the freight charge is also exempt, and refers to [45 IAC 2.2-4-3\(c\)\(2\)](#), which states:

- (a) Separately stated delivery charges are considered part of selling at retail and subject to sales and use tax if the delivery is made by or on behalf of the seller of property not owned by the buyer.
- (b) The following guidelines have been developed:
 - (1) Delivery charge separately stated with F.O.B. destination—taxable.
 - (2) Delivery charge separately stated with F.O.B. origin—non taxable.
 - (3) Delivery charge separately stated where no F.O.B. has been established—non taxable.
 - (4) Delivery charges included in the purchase price are taxable.
- (c) Two considerations must always be kept in mind in applying these guidelines:
 - (1) The rules do not override established interstate commerce exemptions recognized by [IC 6-2.1-3-3](#) (see [6-2.5-5-24\(b\)\(010\)](#) [[45 IAC 2.2-5-54](#)]).
 - (2) The rules are only applicable in determining whether or not the delivery charge of an otherwise taxable sale is also subject to sales or use tax.

(Emphasis added).

The Department refers to IC § 6-2.5-1-5, which states:

(a) Except as provided in subsection (b), "gross retail income" means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for:

- (1) the seller's cost of the property sold;
- (2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
- (3) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
- (4) delivery charges; or

(5) consideration received by the seller from a third party if:

- (A) the seller actually receives consideration from a party other than the purchaser and the consideration is directly related to a price reduction or discount on the sale;
- (B) the seller has an obligation to pass the price reduction or discount through to the purchaser;
- (C) the amount of the consideration attributable to the sale is fixed and determinable by the seller at the time of the sale of the item to the purchaser; and
- (D) the price reduction or discount is identified as a third party price reduction or discount on the invoice received by the purchaser or on a coupon, certificate, or other documentation presented by the purchaser. For purposes of subdivision (4), delivery charges are charges by the seller for preparation and delivery of the property to a location designated by the purchaser of property, including but not limited to transportation, shipping, postage, handling, crating, and packing.

(b) "Gross retail income" does not include that part of the gross receipts attributable to:

- (1) the value of any tangible personal property received in a like kind exchange in the retail transaction, if the value of the property given in exchange is separately stated on the invoice, bill of sale, or similar document given to the purchaser;
- (2) the receipts received in a retail transaction which constitute interest, finance charges, or insurance premiums on either a promissory note or an installment sales contract;
- (3) discounts, including cash, terms, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale;
- (4) interest, financing, and carrying charges from credit extended on the sale of personal property if the amount is separately stated on the invoice, bill of sale, or similar document given to the purchaser;
- (5) any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the purchaser; or
- (6) installation charges that are separately stated on the invoice, bill of sale, or similar document given to the purchaser.

(c) A public utility's or a power subsidiary's gross retail income includes all gross retail income received by the public utility or power subsidiary, including any minimum charge, flat charge, membership fee, or any other form of charge or billing.

(Emphasis added).

Since [IC 6-2.5-1-5\(a\)\(4\)](#) states that delivery charges are considered gross retail income, those delivery charges are subject to sales tax. [45 IAC 2.2-4-3\(c\)\(2\)](#) only provides that the rules listed in [45 IAC 2.2-4-3\(b\)](#) only apply in determining whether or not the delivery charge of an otherwise taxable sale is also subject to sales or use tax. [45 IAC 2.2-4-3\(c\)\(2\)](#) does not say that delivery charges with an otherwise exempt sale are also exempt. The reason the steel banding is exempt is that there is a specific exemption for that banding. The freight charge is a separate charge. Therefore, the freight charge is taxable, but the price of the exempt banding will be removed from the audit calculations.

Protest category twelve consists of parts for an electrical substation. Taxpayer states that it is eligible for the predominant use exemption on electricity and that it purchased steel beams to repair the substation which delivers the electricity to the manufacturing machinery. Taxpayer refers to [45 IAC 2.2-5-8](#), which states in relevant part:

...

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

–EXAMPLES–

(1) Aluminum pistons are produced in a manufacturing process that begins, after the removal of raw aluminum from storage inside the plant, with the melting of the raw aluminum and the production of castings in the foundry; continues with the machining of the casting and the plating and surface treatment of the piston; and ends prior to the transportation of the completed pistons to a storage area for subsequent shipment to customers. Because of the functional interrelationship of the various steps and the flow of the work-in-process, the total production process, comprised of such activities, is integrated.

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

(A) Air compressors used as a power source for exempt tools and machinery in the production process.

(B) An electrical distribution system, including generators, transformers, electrical switchgear, cables inside or outside the plant, and related equipment used to produce and/or supply electricity to exempt manufacturing equipment used in direct production.

(C) A pulverizer for raw materials to be used in an exempt furnace to produce and/or supply energy to

manufacturing equipment used in direct production.

(D) Boilers, including related equipment such as pumps, piping systems, etc., which draw water, or produce and transmit steam to operate exempt machinery and equipment used in direct production.

(E) A work bench used in conjunction with a work station or which supports production machinery within the production process.

(F) 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.

(G) An automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry.

....

(Emphasis added).

The exemption described by example (2)(B) of [45 IAC 2.2-5-8\(c\)](#) applies to an electrical distribution system including generators, transformers, electrical switchgear, cables inside or outside the plant, and related equipment used to produce and/or supply electricity to exempt manufacturing equipment used in direct production. These components are all directly part of the electrical distribution system. The steel beams do not produce or supply electricity to exempt manufacturing equipment. Rather, they support the distribution components. Therefore, the beams do not qualify for the exemption described by example (2)(B) of [45 IAC 2.2-5-8\(c\)](#).

Protest category thirteen consists of diesel fuel used in trucks which move steel coils between stations in the manufacturing process. Taxpayer refers to [45 IAC 2.2-5-12](#), which states in relevant parts:

(a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

...

(g) "Consumed" as used in this regulation [[45 IAC 2.2](#)] means the dissipation or expenditure by combustion, use, or application and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, dies, equipment, machinery, or furnishings.

....

The trucks are exempt since they move steel coils as part of the manufacturing process, as provided by [45 IAC 2.2-5-8\(f\)\(3\)](#). Since the diesel fuel is consumed in the manufacturing process, it is exempt as provided by [45 IAC 2.2-5-12\(g\)](#).

Protest category fourteen consists of the projection method used by the Department to reach the audit results. Specifically, Taxpayer protests that for one of the accounts used by the Department in the sample method, the Department entered the account's month-end total for April 2007, but did not enter the account's month-end totals for August 2007 and October 2007. Taxpayer states that this results in an error in the denominator for that calculation, which in turn results in a calculation error. Taxpayer states that the percentage of error was therefore artificially inflated and the outcome was that the Department over-assessed use tax by \$28,099.41. A supplemental audit will verify the entries and calculations for the months of April, August, and October 2007, and will make changes to the error rate calculations if necessary.

Protest category fifteen consists of limestone used in the production process. Taxpayer states that the limestone is mixed with hydrochloric acid in the pickling and oiling stage of the production process. As with the diesel fuel discussed above, material consumed in the production process is exempt under [45 IAC 2.2-5-12\(g\)](#). The limestone qualifies for this exemption.

In conclusion, Taxpayer is sustained on some of the items protested and denied on the other items protested. Taxpayer is sustained regarding the equipment listed in protest category one, except for the wedge tops, which are only entered once and can only be removed once rather than twice as listed in Taxpayer's protest, and the uncoiler support arms, which are not listed in the audit report. Taxpayer is sustained regarding protest category two, protest category three, protest category four's protest of use tax on parts and tools used in the construction of a new annealing line, protest category six except for the scrap winder and adjustable head hook style spanner wrench, protest categories seven through ten, protest category eleven except for the freight charge, protest category thirteen, protest category fourteen subject to verification via supplemental audit, and protest category fifteen. Taxpayer's protest is denied regarding protest category four's protest of use tax on gas storage tanks, protest category five, and protest category twelve.

FINDING

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

II. Tax Administration—Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of ten percent negligence penalty. Taxpayer states that it acted reasonably and that it was aware of and self-assessed and remitted sales and use taxes. Taxpayer believes that these circumstances are sufficient to warrant waiver of penalty and interest.

Next, the Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...
(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...
the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(Emphasis added.)

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer has been partially sustained on the imposition of use tax as discussed in Issue I above, but has additional use tax assessments which remain as assessed. While the amount of penalty will be recalculated after the adjustment discussed in Issue I, the penalty is properly imposed on the remaining amount.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer is partially sustained on Issue I regarding imposition of use tax. Taxpayer is wholly sustained regarding protest categories two, three, seven, eight, nine, ten, thirteen, fourteen and fifteen. Taxpayer is wholly denied regarding protest categories five and twelve. Taxpayer is partially sustained and partially denied regarding protest categories one, four, six, and eleven. Taxpayer is denied on Issue II regarding the imposition of penalty.

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