

Letter of Findings Number: 10-0046
Sales/Use Tax
For the Years 2006, 2007, 2008

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ISSUE

I. Sales/Use Tax: Equipment.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-5-3; [45 IAC 2.2-5-8](#); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

The taxpayer protests the proposed assessment of use tax on repair and maintenance parts related to front end loaders.

STATEMENT OF FACTS

The taxpayer engages in the business of supplying landscape and horticulture products. Taxpayer also manufactures a variety of mulches and growing mixes. Taxpayer holds a retail merchants certificate to operate a retail center offering various landscaping products. Taxpayer uses front end loaders (the "Loaders") to move raw materials from a dump area to another section of taxpayer's processing facility. Taxpayer also uses the Loaders to place raw materials into a mixer for producing growing mix, placing completed mix into bags, and moving filled bags to pallets.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of taxpayer for the years 2006, 2007, and 2008 (the "Tax Years"). The Department's audit found that taxpayer did not pay sales or use tax on purchases of certain parts and materials used to repair or maintain the Loaders. Taxpayer believed the aforementioned equipment, parts and materials were exempt from sales and use tax under a manufacturing exemption. As a result of the audit, the Department disallowed the manufacturing exemption and assessed use tax on the aforementioned purchases. Taxpayer disagreed with the Department's assessments and submitted a protest. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

I. Sales/Use Tax: Equipment.

DISCUSSION

As provided in IC § 6-8.1-5-1(c), the burden of proving a proposed assessment wrong rests with the taxpayer. Taxpayer protests the proposed assessment of use tax on its purchase of repair and maintenance parts purchased for use on the Loaders, claiming that the Loaders are integral parts of an integrated landscaping products process.

[45 IAC 2.2-5-8\(a\)](#) states that "[i]n 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." However, [45 IAC 2.2-5-8\(b\)](#) notes:

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.

As [45 IAC 2.2-5-8\(c\)](#) makes clear, the equipment must "have an immediate effect on the article being produced." [45 IAC 2.2-5-8\(d\)](#) addresses "preproduction" and states in relevant part:

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process....

Property, per [45 IAC 2.2-5-8\(f\)](#), "used for moving raw materials to the plant prior to their entrance into the production process is taxable." Taxpayer claims it uses the Loaders to both move raw materials from the taxpayer's dump area, and to segregate those raw materials into a form that allows for proper processing in taxpayer's grinding and screening equipment.

The auditor determined that taxpayer used the Loaders during pre-production, and thus that equipment did not come within the ambit of the manufacturing exemptions. During the hearing, taxpayer countered that its mulch and growing mix processes cannot begin without use of the Loaders. Taxpayer's protest mentions that taxpayer uses the Loaders outside the mulch and growing mix facility to mix custom or specialty products.

[45 IAC 2.2-5-8\(g\)](#) addresses taxpayer's arguments, providing that:

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.

Taxpayer, based upon its internal estimates of the Loaders' relative use, asserts that it can apportion fifty (50) percent of the Loaders' use in assisting with the direct production of its landscaping products, and fifty (50) percent for simply moving materials around. Equipment that transports work in progress has been found to meet the requirements of Ind. Code § 6-2.5-5-3. *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 524 (Ind. 1983). In that case, the Indiana Supreme Court found that the equipment used to transport stone from the company's quarry to the crusher and then to stockpiles was directly used in the direct production of tangible personal property. The Cave Stone court deemed the stone work in process and, therefore, the equipment used to move it was entitled to the manufacturing exemption.

[45 IAC 2.2-5-8](#)(c) states in part:

(4) Because of the lack of an essential and integral relationship with the integrated production system in Example (1), the following types of equipment are not exempt:

* * *

(G) Equipment used to remove raw material from storage prior to introduction into the production process or to move finished products from the last step of production.

An analysis of the materials and explanations presented distinguishes taxpayer's case from the situation described in *Cave Stone*. In *Cave Stone*, the taxpayer began the production process by blasting, mining, and removing stone from its own quarry. The *Cave Stone* court's description of taxpayer's "entire operations" included the blasting and mining. That taxpayer used the subject equipment to move the stone, transporting unfinished work in process. Materials and arguments in this proceeding indicate that taxpayer's loading of raw materials into grinding or screening equipment is not part of the production process. Taxpayer uses the Loaders to introduce raw materials to the beginning of the production process. Taxpayer does not use the Loaders to transport unfinished work in process. The Loaders do not have an immediate effect on the materials. The Loaders, as used by the taxpayer in this case, engage in pre-production activities and, therefore, do not qualify for the manufacturing exemption. Any tangible personal property used to maintain or repair the Loaders, is subject to use tax.

FINDING

The taxpayer's protest arguing for a fifty (50) percent exemption from use tax on repair parts and related materials for the Loaders is denied. However, the Department should review and adjust its assessment with respect to a few select invoices regarding repairs to exempt equipment, such as conveyors or grinding machinery, or invoices that the Department may have duplicated in its audit report.

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