

**Letter of Findings: 10-0207**  
**Gross Retail Tax**  
**For the Years 2006, 2007, and 2008**

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**ISSUES**

**I. Sales and Use Tax – Exemptions.**

**Authority:** IC § 6-2.5-1-26; IC § 6-2.5-5-3; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10](#); [45 IAC 2.2-5-39](#); [45 IAC 2.2-5-40](#); Sales Tax Information Bulletin 29 (July 2005).

Taxpayer protests the assessment of tax on purchases of tangible personal property and rentals of equipment.

**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 an Indiana manufacturer of auto parts. Taxpayer has two divisions operating as manufacturing plants in Indiana: a metal stamping plant and a plant that manufactures fluid level dipstick holders. The Department of Revenue ("Department") conducted an audit review of taxpayer's records concluding that taxpayer owed additional gross retail (use) tax on items purchased during the 2006, 2007, and 2008 tax years ("Tax Years").

Taxpayer timely protested the assessments. Taxpayer disagreed with a portion of the audit's conclusions and submitted a protest to that effect. To support its protest, taxpayer submitted an itemized list of various items, along with one or two sentence explanations. The Department gave taxpayer the opportunity to present additional evidence and request an administrative hearing. Taxpayer did not present additional evidence nor request a hearing, leaving the Department to review the protest file and issue a decision based upon the information in the file. This Letter of Findings results.

**I. Sales and Use Tax – Exemptions.**

**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 or rental of select pieces of equipment; on its purchase of steel sheets; and on its purchase of beverages. Taxpayer claims that its purchases or rentals should enjoy exemptions from assessment of use tax.

[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.

[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 and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The Department assessed use tax on taxpayer's rental of two forklifts. Taxpayer claims it uses one of the forklifts ("Forklift 1") to both receive and move, i.e., introduce, raw materials into taxpayer's manufacturing process, and to load finished goods from the manufacturing process to taxpayer's shipping area. Taxpayer asserts use of the other forklift ("Forklift 2") to transport work in progress, or WIP, from one manufacturing operation to the next.

Revisiting [45 IAC 2.2-5-8](#) as it addresses transportation equipment:

(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.

....

(f) Transportation equipment.

(1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the

production process is taxable.

(2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.

(3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

(4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

–EXAMPLES–

(1) A manufacturer of clay pipe uses forklift tractors to transport the pipe from the machine in which it is formed to the kiln. The forklift tractors are exempt.

(2) A metal and alloy manufacturer pulverizes raw materials for use in an exempt furnace. Weigh bins are utilized for the temporary storage of the exempt materials after pulverization and prior to use in an exempt furnace. Transportation equipment used to transport the pulverized raw material to and from the weigh bins is exempt.

(3) A forklift is used exclusively to move work-in-process from a temporary storage area in a plant and to transport it to a production machine for processing. Because the forklift functions as an integral part of the integrated system comprising the production operations, it is exempt.

(4) A forklift is used exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers. The forklift is taxable because it is used outside the integrated production process.

**(5) A forklift is regularly used 40 [percent] of the time for the purpose described in Example (3) and 60 [percent] of the time for the purpose described in Example (4). The taxpayer is entitled to an exemption equal to 40 [percent] of the gross retail income attributable to the transaction in which the forklift was purchased.**

....

**(Emphasis added).**

Therefore, any piece of equipment must be directly used in the direct production of tangible personal property to qualify for the manufacturing exemption, as provided by [45 IAC 2.2-5-8\(c\)](#) and IC § 6-2.5-5-3(b). This is commonly referred to as the "double-direct" test.

Taxpayer did not present any evidence to support the brief division of duties between its two forklifts. Consequently, taxpayer's protest cannot overcome the Department's assessment of use tax on both Forklift 1 and Forklift 2 rental fees.

Taxpayer protests the Department's use tax assessment on a power uncoiler, and a coil straightener. Taxpayer argues that, per the Department's Letter of Findings 07-0125, these machines qualify for the manufacturing exemption. The Department reminds taxpayer that each letter of findings or other document issued as a result of an administrative hearing or procedure relies on facts and circumstances specific to a particular taxpayer. Taxpayer did not present any evidence demonstrating that taxpayer's use of its power uncoiler or coil straightener mimics description of the use of the machines or the corresponding facts and circumstances provided in the cited letter of findings. Therefore, taxpayer has not met its burden of proof with respect to the power uncoiler or coil straightener.

Taxpayer argues that its use of a replacement scrap conveyor qualifies for the manufacturing exemption from use tax. Taxpayer's brief explanation relies upon a theory that because this machine moves product that taxpayer ultimately sells, similar to the conveyors used to move materials in taxpayer's manufacturing process, taxpayer does not owe use tax on the replacement scrap conveyor. However, taxpayer has not presented any evidence that taxpayer directly uses this conveyor in direct production, manufacture, fabrication, assembly, or finishing of tangible personal property. Taxpayer has not presented evidence sufficient to overcome the Department's assessment of use tax on purchase of the replacement scrap conveyor.

To its list of alleged exempt items, taxpayer also includes a portion of a parts conveyor called a "slider bed." Taxpayer again provides a one sentence explanation, stating that the conveyor transfers work in progress from one operation to the next. However, taxpayer has not presented any evidence that taxpayer directly uses this slider bed, or this parts conveyor in direct production, manufacture, fabrication, assembly, or finishing of tangible personal property. While the conveyor may be a necessary part of taxpayer's metal fabrication process, the conveyor is not machinery that has an immediate effect on taxpayer's products. During the time the taxpayer's WIP are on the conveyor, the raw materials or assembly pieces are not being mixed, altered, combined, or changed in form. The conveyor simply functions to transport the products in process during the manufacturing process. Taxpayer has not presented evidence sufficient to overcome the Department's assessment of use tax on purchase of the slider bed.

Taxpayer's list also includes storage racks used for taxpayer's finished products. [45 IAC 2.2-5-10\(e\)](#) states: Tangible personal property used in or for the purpose of storing raw material, work in process, semifinished or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being processed or refined from one (1) production step to another.

(2) Storage facilities or containers for finished goods after completion of the production process are subject to tax.

Taxpayer claims that its customers' purchase of taxpayer's finished goods includes the storage racks. However, taxpayer has not presented any evidence establishing the storage racks' necessity for moving materials being processed or refined from one production step to another, nor any evidence showing the racks as part of taxpayer's goods sold. Taxpayer has not presented evidence sufficient to overcome the Department's assessment of use tax on purchase of the storage racks.

Taxpayer writes one sentence each to argue that tags taxpayer uses to identify WIP and finished goods qualify for a manufacturing exemption from use tax. Taxpayer alleges that it uses the WIP tags for internal control. Internal control, which includes instructing employees, falls within managerial functions. Tangible personal property used for managerial functions does not qualify for the manufacturing exemption. [45 IAC 2.2-5-8\(j\)](#).

Taxpayer's tags designating finished goods convey information to taxpayer's customers. Taxpayer did not provide details regarding the information included on these labels. Taxpayer has not given any evidence that the labels affect the production of the product, nor that the labels serve a necessary and integral function in taxpayer's production process. The finished goods labels do not qualify for the manufacturing exemption. Id.

Taxpayer concludes its arguments regarding manufacturing exemption claims with steel sheets that taxpayer purchased specifically for employee safety. Taxpayer does not provide further details or evidence showing use of the steel sheets in taxpayer's manufacturing process. Tangible personal property used for "safety or fire prevention equipment which does not have an immediate effect on the product" does not qualify for the manufacturing exemption. Id.

Finally, taxpayer challenged the Department's assessment of use tax on beverages taxpayer furnished to its employees during the Tax Years. Taxpayer incorrectly cites to [45 IAC 2.2-5-40](#), asserting that fruit juices enjoy an exemption from sales or use tax; that exemption instead falls under [45 IAC 2.2-5-39](#). However, taxpayer has not provided any information to overcome the Department's determination that taxpayer's beverages did not contain at least fifty percent (50 [percent]) natural fruit. IC § 6-2.5-1-26; Sales Tax Information Bulletin 29 (July 2005). Taxpayer's beverages, therefore, fall under the "soft drink" designation, which are taxable under [45 IAC 2.2-5-40](#).

#### FINDING

Taxpayer's protest is respectfully denied.

## II. Tax Administration—Negligence Penalty.

#### DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the Tax Years. Taxpayer protests the imposition of penalty. 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.

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

The department shall waive the negligence penalty imposed under [\[IC 6-8.1-10-2.1\]](#) 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 incurred deficiencies which the Department determined were due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). In taxpayer's protest, taxpayer has affirmatively established that taxpayer had reasonable cause and was not negligent, as required by [45 IAC 15-11-2\(c\)](#).

#### FINDING

Taxpayer's protest is sustained.

#### CONCLUSION

Taxpayer's protest is denied with respect to manufacturing exemption from use tax claims pertaining to two

forklifts, a power uncoiler, a coil straightener, a replacement scrap conveyor, a parts conveyor slider bed, storage racks, identification tags, and steel sheets. Taxpayer's protest is also denied with respect to an exemption from use tax claim pertaining to beverages furnished to employees. However, taxpayer's protest against the negligence penalty is sustained.

*Posted: 10/27/2010 by Legislative Services Agency*

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