

**Letter of Findings: 09-1030**  
**Sales and Use Tax**  
**For the Years 2006, 2007, and 2008**

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**ISSUE**

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

**Authority:** IC § 6-2.5-1-1 et seq.; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-11](#); [45 IAC 2.2-5-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't of State Revenue v. U.S. Steel Corp., 425 N.E.2d 659 (Ind. Ct. App. 1981); Indiana Dep't of State Revenue v. Harrison Steel Castings Co., 402 N.E.2d 1276 (Ind. Ct. App. 1980).

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

**STATEMENT OF FACTS**

Taxpayer, an Indiana manufacturer, produces slit coil, edge conditioned coil, cut-to-length strip, and oscillate wound coil. Pursuant to an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer purchased tangible personal property, such as building maintenance supplies and floor maintenance supplies, without paying sales tax at the time of the transactions or self-assessing and remitting the use tax to the Department during 2006, 2007, and 2008. The Department's audit assessed additional use tax, based on a statistical sample and projection method. The Department's audit also imposed interest and penalty.

Taxpayer paid the total proposed assessments in full. Taxpayer, however, protests the assessment related to its purchases of the "sorbis mats" ("Mats"), which were placed on the floor, underneath rolled steel. Subsequently, Taxpayer submitted additional documentation to support its protest and requested that the Department makes the determination based on its documentation in lieu of a hearing. Therefore, this Letter of Finding is written based on the documentation Taxpayer submitted and information available in Taxpayer's protest file. Additional facts will be provided as necessary.

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

**DISCUSSION**

The Department's audit assessed Taxpayer use tax on purchases of the Mats. Taxpayer, to the contrary, claimed that it was entitled to statutory exemption.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). An exemption from use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974).

IC § 6-2.5-5-3(b) states:

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.

IC § 6-2.5-5-5.1(b) provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment are directly used in the production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. Id. An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process."

[45 IAC 2.2-5-8\(c\)](#), example 1.

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that the change must be substantial resulting in a transformation of the property into a different and distinct product.

The exemption for direct use in production is further explained at [45 IAC 2.2-5-11](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of tangible personal property to be directly used by the purchaser in the direct production or manufacture of any manufacturing or agricultural machinery, tools, and equipment described in [IC 6-2.5-5-2](#) or 6-2.5-5-3 [[IC 6-2.5-5-3](#)].

(b) The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to tangible personal property directly used in the direct production of manufacturing or agricultural machinery, tools, and equipment to be used by such manufacturer or producer.

(c) The state gross retail tax shall not apply to purchases of tangible personal property to be directly used by the purchaser in the production or manufacturing process of any manufacturing or agricultural machinery, tools, or equipment, provided that the machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect upon the article being produced or manufactured. The 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.

(d) For the application of the rules [subsections] above, refer to Regs. 6-2.5-5-3 [[45 IAC 2.2-5-8](#) through [45 IAC 2.2-5-10](#)] with respect to tangible personal property used directly in the following activities:

pre-production and post-production activities; storage; transportation; tangible personal property which has an immediate effect upon the article produced; maintenance and replacement; testing and inspection; and managerial, sales, and other nonoperational activities.

The exemption for direct consumption in production is further explained at [45 IAC 2.2-5-12](#), in part, as follows:

(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.

(b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.

(c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The 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.

[45 IAC 2.2-5-8\(d\)](#) states:

Pre-production and post-production activities. "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.

[45 IAC 2.2-5-8\(f\)](#) provides:

(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.

[45 IAC 2.2-5-8\(g\)](#) further states:

"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. **(Emphasis added).**

Referring to [45 IAC 2.2-5-8\(c\)](#), example (2)(F) and [45 IAC 2.2-5-8\(e\)\(3\)](#), Taxpayer believes that its purchases of the Mats were exempt. Taxpayer stated:

These coils are staged for a[n] undetermined amount of time before moving into the Annealing Ovens.... The mat serves two purposes. The coils have oil on them that runs off as they set. If it were not contained in the mats it would create a safety hazard for the crane operator moving them. The mats also protect the coils from contamination of dirt and scratches if they come in contact with the concrete floor.

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

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--

...

(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.

...

**(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. (Emphasis added).**

In *Indiana Dep't of State Revenue v. U.S. Steel Corp.*, 425 N.E.2d 659 (Ind. Ct. App. 1981), the appellate court affirmed the trial court's findings, in favor of the taxpayer, U.S. Steel Corp., that it was entitled to the manufacturing exemption concerning its purchases of personal protective equipment, including, but not limited to, prescription safety eyeglasses, protective mittens, hardhats, goggles, masks, hoods, jackets and aprons. The U.S. Steel court refined the application of the "double direct standard" illustrated in *Indiana Dep't of State Revenue v. Harrison Steel Castings Co.*, 402 N.E.2d 1276 (Ind. Ct. App. 1980) and focused on "whether the safety equipment is an integral part of manufacturing and operates directly on the product during production."

Acknowledging that the "U.S. Steel's safety equipment was one of the tools used by workers to accomplish the job," The U.S. Steel court concluded that:

Since steel can be made only because shielded workers deal directly with the raw materials of the product, the shields not only protect the worker but are a part of manufacturing which operates directly on the product during production.

U.S. Steel, 425 N.E.2d at 664.

In this instance, Taxpayer's documentation failed to demonstrate that the Mats were directly used to protect its employees and had immediate effects upon the products being produced in its production. Taxpayer's documentation also failed to demonstrate how the Mats are used to prevent contamination of the product during production. The fact that Mats may be considered essential to the conduct of the business of manufacturing because its use is required by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced." Thus, Taxpayer's purchases of Mats were not exempt under the above mentioned regulation and case law.

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

Storage equipment. Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

...

**(3) 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. **(Emphasis added).**

In this instance, Taxpayer's documentation showed that Mats are "cloth" placed on the floor. Thus, Mats are not "storage facilities or containers" as outlined in [45 IAC 2.2-5-8\(e\)](#). As the Department's audit noted that:

As these coils are set on the plant floor, oil may drip from them. As the taxpayer stated, if this oil is not contained, it will be all over the plant floor. In order to keep the plant floor clean and dry, the taxpayer lays these oil absorbent mats on the floor under the coils of rolled steel to catch and absorb the oil that may drip on the floor. These floor mats are not required to allow the crane operator to move the coils of rolled steel without injury. These floor mats are rather maintenance items that are used to keep the plant floor clean and dry and are not storage equipment such as containers or racks.

Therefore, while Mats may be considered essential to the conduct of the business of manufacturing because its use is required by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced." Thus, Taxpayer's purchases of Mats were not exempt pursuant to [45 IAC 2.2-5-8\(e\)](#).

In short, Taxpayer's purchases of Mats were subject to sales/use tax. Since Taxpayer did not pay sales tax at the time of its purchases, the use tax is properly imposed.

## FINDING

Taxpayer's protest on its purchases of Mats is respectfully denied.

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